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Taxing the digital economy

The unilateral approach

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The rise of the digital economy and the substantial profits generated by some digital businesses, together with the opportunity for tax base erosion and profit shifting afforded by digital business models, have resulted in a call to update the international tax system to address the digital economy. Tasked with formulating an international approach, the OECD has yet to propose a viable reform package. In the absence of multilateral consensus, many jurisdictions have begun to formulate unilateral rules to tax the digital economy. The inconsistency of these rules is likely to increase the tax burden of digitalised businesses operating internationally.

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Digitalisation has been observed to be the most significant development in the global economy since the industrial revolution. Recent technological advances have driven dynamic changes in how and where companies do business and this pace of change seems unlikely to slow.

This has created significant concerns for taxation authorities around the world, which can see huge profits being generated by businesses at the forefront of the digital economy revolution but struggle to tax such profits under the existing international tax framework. This issue has also crossed over into the mainstream in the form of political and media pressure to ensure that multinational business pays its fair share of tax in the countries where profits are generated, giving additional focus and impetus to finding a solution. Numerous international bodies are looking at this issue, but it is proving a complex problem with no easy solution. Frustrated by a lack of progress, or perhaps as a catalyst to further international progress, individual jurisdictions are increasingly adopting unilateral measures to tax the digital economy.

This article seeks to provide an overview of the different unilateral approaches being taken to the taxation of the digital economy around the globe and to put these into the wider context of the international efforts to determine a multinational approach to this issue.

The problem

The perceived problem with taxing the digital economy, and in particular some of the new business models that digitalisation has fostered, is that digitalisation has enabled businesses to generate large profits from consumers in a jurisdiction without a physical presence in that jurisdiction. Taxing such profits under the current international tax system is problematic, since this system operates predominately by reference to physical presence in a jurisdiction; i.e. a jurisdiction can only tax the profits of a business if such profits are associated with a form of presence in that jurisdiction.

Digitalisation allows more traditional business models (such as the sale of goods/services, i.e. e-commerce) to sell to consumers without the need for physical presence (or at least material physical presence) in the customer jurisdiction. It also paves the way for new business models, based upon user participation, to generate income without making any traditional sales to the user base in question; e.g. social media businesses that generate revenue through advertising sales. User participation business models are particularly problematic in the context of the existing tax system. While there may be no presence or transaction in a jurisdiction, the user base in that jurisdiction, that drives the ability for the business to generate revenue could be very large and key to the profitability of the business.

A further challenge for the international bodies looking at this issue is the sheer diversity of digital business models. There is no easy answer to what constitutes the digital economy, making it very difficult to propose a single effective tax measure targeting the digital economy. Furthermore, the digital economy continues to evolve at a rapid pace and there are concerns that any measures introduced today may be quickly superseded by further digital evolution.

These issues have caused many to question whether it is in fact necessary or practical to radically reform the current international tax system to respond to the digital economy. However, this view does not appear to be shared by the international bodies looking at this issue or the increasing number of jurisdictions introducing unilateral tax measures targeting the digital economy, as detailed further below.

International work

To give context to the unilateral measures discussed below, it is useful to briefly consider the work undertaken to date by the OECD, the UN and the EC on the taxation of the digital economy.

The OECD

Many of the tax issues that the OECD is trying to address as part of its work on base erosion and profit shifting (BEPS) have been highlighted or accentuated by businesses operating in the digital economy. Indeed, the importance of the digital economy in the context of the BEPS project is highlighted by the fact that Action 1 on the list of 15 BEPS action items was a report on addressing the tax challenges of the digital economy.

However, the Action 1 report produced in 2015 was essentially inconclusive. It reported that it expected the outcome of other Actions to address some of the key features of the digital economy that exacerbate BEPS risks; for example, the modifications to the permanent establishment (PE) definition to narrow the scope of certain exceptions and prevent avoided PE arrangements through artificial contracting structures, and the changes to transfer pricing guidance to focus value on the functions and risks assumed within a group. However, the Action 1 report was not able to determine a viable solution for addressing the wider issues with the digital economy.

In this context, the OECD considered the following specific taxing options for the digital economy:

- taxing nexus in the form of significant economic presence, i.e. a virtual PE;
- a withholding tax on certain types of digital transactions; and
- an equalisation levy, i.e. a tax imposed on the turnover of non-resident businesses with a significant economic presence as a means of ensuring equal treatment for domestic and foreign businesses.

However, none of these were considered suitable, partly because of material concerns about the design of such taxes, the potential negative impact of turnover or gross-basis taxation, double taxation and trade agreement challenges, and partly because it was hoped that other BEPS changes and also indirect tax (VAT/GST) changes would address the majority of the BEPS issues associated with the digital economy. The report ended by concluding that further analysis was required with the objective of reporting again in 2020, effectively kicking the issue into the long grass.

However, with the 2020 deadline drawing nearer, the ball has now been picked up again. As demonstrated below, much focus is now being placed on the meeting of the G20 finance ministers in April 2018, where the OECD Task Force on the Digital Economy is required to provide an interim report on its further work in this area.

European Commission

Separately from the OECD initiative, the EC has also been considering the taxation of the digital economy as part of its wider digital single market initiative. In a communication from the EC in September 2017, the Commission articulated its view of the taxation issues posed by the digital economy. This communication has already been covered in detail in this journal but, by way of brief summary, the communication evidences frustration within the EC at the lack of progress being made at an international level on the issue. Primarily, the communication is intended as a spur to the international community to reengage in this issue, but it also makes clear that if progress is not made when the OECD provides its interim report later this year, it will consider implementing measures at an EU level.

With this objective in mind, the communication sets out options for taxing the digital economy within the EU, considering that a modified form of the pre-existing common consolidated corporate tax base proposal (CCCTB) could effectively capture digital activities. The CCCTB seeks to apportion the profits of businesses operating in the EU across relevant EU jurisdictions based upon factors such as sales and value add, rather than presence, and could therefore be used to capture profit derived from users as well as sales. However, the CCCTB has its own implementation difficulties and member state opposition, and therefore may not itself be an effective option in the short term.

Acknowledging this, the Commission suggests short term solutions similar to those concluded by the OECD:

- an equalisation tax on turnover of digitalised companies;
- a withholding tax on digital transactions; and
- a levy on revenues generated from the provision of digital services or advertising activity.

These potential solutions are acknowledged to have issues, but each is being analysed further by the EC. Currently, based on subsequent EU discussions, an equalisation levy appears to be the most favoured option.

United Nations

This issue has also been considered by the UN Committee of Experts on International Cooperation in Tax Matters in their October 2017 report *Tax challenges of digitalisation*. The issues and concerns flagged are similar to other reports, but in many ways the call for action is stronger. This stems from the committee's position as a body that represents both developed and developing countries. Developing countries are often the main source of tax revenue loss in the digital economy, as developing countries provide a substantial consumer and user base, but are less likely to host digital economy businesses.

The UN report places a strong focus on reforming the PE concept. In particular, the report recommends the introduction of a new taxable nexus based on the concept of 'significant economic presence', i.e. the creation of a 'virtual' PE. The objective of this approach is to determine nexus by factors that determine a persistent and sustainable interaction with the economy of a country using technological processes (e.g. digital presence, active monthly users, online contacts, data collection).

Unilateral measures

As can be seen from the above, much work is still required before an international consensus on taxing the digital economy is reached. Consequently, an increasing number of jurisdictions have introduced, or are in the process of introducing, unilateral, domestic tax measures that target the digital economy. Of course, this is exactly the approach that the work of the international bodies sought to avoid, as country by country adoption of different, inconsistent rules will almost inevitably lead to double taxation and material administrative cost for business. However, the delayed timetable at the international level, coupled with domestic political, social and revenue raising pressures, have made unilateral measures inevitable.

Below, we look at the more developed measures obviously targeting the digital economy in a variety of jurisdictions, as well as the views of key jurisdictions on the digital economy. The unilateral measures take a range of forms, but broadly can be broken down into the following categories:

- virtual PE measures;
- equalisation levies;
- withholding taxes;
- diverted profit taxes; and
- VAT/GST type indirect taxes.

See the table opposite for a headline summary of the digital economy tax measures discussed below.

United Kingdom

The UK has taken a lead role in the wider BEPS project and has also taken domestic steps to move ahead of the BEPS process in certain circumstances. One obvious example of this in relation to the digital economy is the diverted profits tax (DPT), introduced in 2015. While not limited in its final scope to digital businesses, the DPT was conceived as a response to base erosion and profit shifting activities particularly facilitated and utilised by digital businesses; e.g. avoiding UK PE treatment through segregation of sales and contracting activities or the use of intellectual property (IP) licences to strip profit from the UK.

However, the DPT still fundamentally requires some form of business presence in the UK to apply and therefore does not fully address the tax issues raised by digitalised businesses. These issues, and the UK's view on these issues, were set out in greater detail in the UK government's position paper on 'Corporate tax and the digital economy', issued at the time of the 2017 Autumn Budget. It is clear from this position paper that the UK considers that international efforts to tax the digital economy should focus in particular on methods to tax value driven by user participation. The paper advocates long term tax reform that will tax value created for a business through material and active user participation in a jurisdiction; and allocate profit between jurisdictions based on user base metrics (such as monthly active users).

However, the above is recognised as a long term objective that requires broad international consensus and adoption. Consequently, interim unilateral proposals are also discussed. Of the range of proposals discussed at an international level, the UK expresses a preference for a tax on revenues generated from the provision of digital services to the UK market. The intention would be to target this at pure user participation business models (i.e. where revenue is generated through advertising or intermediation), not at essentially retail businesses selling goods through online platforms. It is recognised that much more work would be required on this proposal in order for it to be implemented but, as with the position of the EC, the UK expresses a willingness to proceed with a measure of this nature should it perceive that successful progress has not been made by the OECD when it presents its interim report to the G20.

In addition, the position paper and associated budget announcements contained one specific measure targeting the digital economy. Intended for introduction in April 2019, the UK has proposed a targeted royalty withholding tax applicable to IP royalties paid by a non-UK resident entity to a related party in a low tax jurisdiction, where profits out of which the royalty is paid are associated with the exploitation of the relevant IP in the UK (through sales to UK customers). Although a relatively focused measure in its scope and probable application, conceptually this withholding tax represents a significant step towards taxing the digital economy by reference to nexus of consumer and user base rather than the physical presence of the taxpayer. The proposed tax requires no UK presence for the taxpayer beyond a UK customer base.

United States

When analysing the taxation of the digital economy in the US, it is instructive to consider the different approaches at federal and state level. While US federal tax has argued strenuously against separate rules for the digital economy, the issue of remote taxation has become increasingly important to states as they struggle to ensure that tax is paid on e-commerce sales. Similar to the unilateral action occurring on an international level, the individual states have resorted to acting unilaterally in an attempt to solve their digital economy tax woes.

From a US federal tax perspective, the introduction of unilateral measures to tax the digital economy represents a troubling development that is concerning both US Treasury officials and the US business community. In light of the fact that the US recently enacted the largest restructuring of the US federal tax code since the Tax Reform Act of 1986, multiple unilateral approaches that diverge from the OECD BEPS multilateral framework are unwelcome at best.

In particular, the digital PE option is a concern for the US, in large part – but not solely – because it depends on a notion of ring-fencing the digital economy. The work of the OECD in connection with BEPS is based on a presumption that global tax policies should be principles-based, and that proposals should be agreed internationally through the OECD and implemented in a common and coordinated fashion. In its comments on the UK Treasury's digital economy position paper, the US Council for International Business (USCIB) stated that 'retreating from BEPS standards and adopting more onerous rules unilaterally will increase the likelihood of double taxation as different standards proliferate'. Similarly, interim fixes are undesirable, and potentially create barriers to achieving the goals the BEPS project was designed to reach. Interim or temporary solutions are disruptive, and in practice are difficult to revoke or replace. Essentially, as noted by the USCIB, they have 'an unfortunate tendency to become permanent'.

Considering the recent US tax reform in the context of the digital economy, although the centrepiece of the bill formerly known as the Tax Cuts and Jobs Act ('the Act') is the significant reduction in the corporate tax rate, the Act also revises the scheme of taxation applicable to multinational business enterprises (MNEs) in several important respects. The transactionally focused provisions of the Act require or encourage US-headquartered MNEs to return taxable activities to the US tax base, and appear designed to neutralise any perceived benefit from aggressive tax regime arbitrage, which has previously, but not in any way exclusively, been particularly accessible to businesses operating in the digital economy.

However, the Act does not explicitly target the digital economy, consistent with the US view that the so-called 'digital economy' is not a separate economy and should not be ring-fenced. Thus, the Act does not anticipate the creation of a digital economy PE, the imposition of a digital economy equalisation levy, or any other mechanism designed to identify and segregate 'digital economy' profits for tax purposes. Nonetheless, taken together, the Act's provisions will influence structuring of business operations with respect to digital goods and services.

The Act reduces the US corporate tax rate from 35% to 21%, which will benefit all US companies, including those operating in the digital economy. Even more favourable rates apply to profits derived by US companies from offshore operations, specifically in the form of a 100% dividends-received deduction for the foreign-source portion of dividends and a 37.5% deduction for income of US corporations derived from sales (including royalties) and services provided to non-US persons. These changes will benefit digital businesses operating in the US, and may encourage restructuring by US multinationals to fully appreciate the benefits. For example, companies may consider relocating activities and intangibles to the US to take advantage of the tax deduction for goods and services provided to non-US persons, which should apply to offerings of digital goods and services.

The benefits of US tax reform are balanced by provisions in the Act that subject US companies to a minimum tax of 10.5% on the earnings of their non-US subsidiaries in excess of a proxy return on tangible foreign property. In addition, there are new provisions to curtail future offshoring of valuable intangibles, such as anti-hybrid rules that deny deductions for interest or royalties paid between related parties, the current taxation of outbound transfers of foreign goodwill or going concern value, and a minimum tax on US companies making deductible payments to related parties. The minimum US tax on foreign profits discourages the use of holding companies in low tax jurisdictions, and may encourage some US multinationals to restructure existing foreign operations in a manner that minimises residual US tax on profits.

In summary, while there are still open questions to be resolved in connection with the Act, it implements many of the objectives articulated in the OECD BEPS multilateral framework and should therefore curtail BEPS activity for both the digital and traditional economy. Further, it is likely that companies will be required to engage in some restructuring, either to take full advantage of the benefits of the Act or to minimise the additional tax cost.

Although US federal tax law avoids any special provisions for the taxation of the digital economy, US state law has been particularly focused on this question. The state law 'physical presence' standard for nexus was established by the 1992 Supreme Court decision in *Quill Corp. v North Dakota* (1992) 504 US 298 and is still the standard today. This generally means that a company must have a physical presence in a state if it is going to be required to collect sales taxes for sales made into that state. Congressional proposals to allow states to impose sales tax collection requirements on remote sellers, including digital businesses, have been introduced in almost every legislative session since 2003, but none have been passed.

As a result, some states have resorted to passing laws or adopting regulations that directly challenge or test the limits of *Quill*. On 12 January 2018, the Supreme Court agreed to hear *South Dakota v Wayfair Inc.*, which concerns the legality of a South Dakota law requiring out-of-state and internet retailers to collect sales tax on sales into the state. The South Dakota law was adopted in 2016 as a direct challenge to *Quill*, and requires out-of-state sellers to collect and remit sales tax based not on their physical presence in the state, but on their economic connection to South Dakota. Thus, just as the EU and other international tax jurisdictions consider the notion of a 'digital' definition of PE, so the Supreme Court will consider a state law with the same basic goal: to redefine nexus in order to capture more tax related to digital economic activity in the state.

Non-US digital businesses that sell into the US will want to monitor the developments in the *Wayfair* case closely, as the PE and other treaty standards do not apply to state taxes and, in particular, the requirement for collection of state sales taxes.

In conclusion, it will be important for multinational companies to monitor the developments in the approach to the digital economy within the US to determine its potential impact on the US approach to the international taxation of the digital economy. It may be that in the US there are separate standards for the collection of indirect taxes, such as sales tax on sales in the digital economy, and the direct taxation of income earned by sellers in the digital economy. As to the former, an economic nexus may be sufficient to require collection by sellers of digital goods and services; but the current position in the US is that such economic nexus standards should not be extended to the direct taxation of income.

Unilateral measures

Country	Digital economy tax measure	Status
Austria	Equalisation levy (advertising tax)	Proposed
Australia	Diverted profits tax	Active
	GST	Active
China	VAT	Active
Hungary	Equalisation levy (advertising tax)	Active
Italy	Withholding tax (web tax)	Active
	Virtual PE/diverted profits tax	Active
India	Equalisation levy	Active
	Virtual PE	Proposed
Israel	Virtual PE	Active
	VAT	Active
Kuwait	Virtual PE	Active
New Zealand	GST	Active
Saudi Arabia	Virtual PE	Active
Taiwan	Virtual PE	Active
	VAT	Active
Turkey	Withholding tax	Active
	Virtual PE	Active
	VAT	Active
UK	Diverted profits tax	Active
	Withholding tax (on specific non-resident royalties)	Proposed
US	No specific federal digital economy measures	n/a
	State sales tax collection	Active

Italy

Italy has recently adopted a unilateral tax measure that specifically targets the digital economy. Italian 2018 Budget Law (Law No. 205/2017) introduced a tax on digital transactions (a so-called 'web tax'), applicable to services rendered by electronic means. The web tax is due to enter into force on 1 January 2019 and applies to digital services provided by both Italian entities and non-resident entities, at a rate of 3% of the consideration paid (net of VAT) for the digital service in question.

The exact definition of 'digital services' remains to be determined by a decree of the Ministry of Economy and Finance, to be issued by 30 April 2018. However, such services may generally be defined as those provided through the internet or an electronic network which are essentially automated or accompanied by negligible human intervention. A de minimis threshold operates so that the tax is only applicable to entities which perform digital services exceeding 3,000 units (effectively transactions) in a calendar year. Also, as a further limitation to the scope of the tax and in recognition of one of the key issues with taxing the digital economy, digital services provided to private individuals are excluded from the scope of the web tax on the basis that individuals cannot act as withholding agents.

In addition to the web tax, Italy is also revising its domestic definition of PE to address the digital economy. Italian 2018 Budget Law, in line with the guidelines set forth by BEPS Action 7 on digital transactions, amended the definition of PE in the Italian Income Tax Code to provide that 'a significant and continuous economic presence in the Italian territory, built in such a way that it will not result in a physical presence in Italy' may trigger the presence of a PE, effectively introducing a form of virtual PE or DPT-equivalent concept.

India

India has been an early adopter of tax measures targeting the digital economy. In 2016, India introduced an equalisation levy whereby 6% of any payment made to a non-resident in respect of online advertising is withheld by the Indian taxpayer. The equalisation levy was regarded as the Indian government's response to the issues raised in the OECD BEPS Report on Action 1.

Furthermore, India is planning to introduce additional measures to address the taxation of the digital economy as part of the government's Budget 2018. India is proposing to tax income generated by technology or internet-driven companies on the digital transfer of goods and services to users in India. The Finance Bill 2018-19 proposes an amendment to the definition of 'business connection' in India to include 'significant economic presence'. Such a move could impose a 40% tax on any foreign company rendering digital goods or services to India. India's 2018 budget memorandum argues that 'the existing nexus rules based on physical presence do not hold good anymore for taxation of business profits in the source country. As a result, the right of the source country to tax business profits that are derived from its economy is unfairly and unreasonably eroded.' Businesses which find themselves within the ambit of the revised definition of the nexus rule may have to pay taxes in India on income attributable to transactions or activities in India, irrespective of whether or not they have a permanent place of business in India.

Israel

In April 2016, Israel published guidelines (in an Israeli Tax Authority circular) on changes to income tax and VAT which expand the concept of the PE to include online businesses which sell or provide services through the internet to Israeli residents. The proposals focus on instances in which income of a foreign company could be attributed to a PE in Israel in the context of the digital economy. Notably, the guidelines provide criteria, according to which a foreign company can be deemed to have a PE where it has a 'significant digital presence' in Israel. The criteria include the following:

- a significant number of contracts for providing internet services to Israeli residents;
- a large number of Israeli customers using the digital service;
- adjustments to the online services for Israeli users (e.g. the use of the Hebrew language, style, the use of Israeli currency);
- high web traffic by Israeli users; and
- a close correlation between the consideration paid to the foreign company and the level of internet usage by Israeli users.

In relation to VAT, the guidelines state that non-resident suppliers of digital services that carry out substantial business in Israel must register and account for VAT in Israel.

Australia

Australia introduced the Multinational Anti-Avoidance Law (MAAL) in 2016. It is broadly similar in approach to the UK's DPT, which came into force the previous year. Although the MAAL was not specifically targeted at the digital market, the reform is said to have impacted multinational companies generating sales in Australia by operating local initiatives but entering into contracts with customers remotely. Given the connection with the UK's DPT, it is assumed that the MAAL will influence the digital economy in a similar way to the UK tax.

Further, with effect from 1 July 2017, Australia enacted legislation under which supplies of digital services (e.g. movie streaming, image downloads) purchased by Australian consumers from overseas will be subject to the goods and services tax (GST). The legislative change extends the scope of GST to digital products and other services imported by Australian consumers and is intended to ensure that the GST system does not favour international digital service providers ahead of domestic Australian-based providers.

Austria

As part of its policy agenda for 2017/18, the Austrian federal government proposed the introduction of a set of measures which extended the scope of the Austrian advertisement tax ('Werbeabgabe') to include online advertising. Such measures were due to come into force in early 2018. The proposals would extend the tax on advertising revenue to digital formats and tax digital services that are acquired by Austrian customers from companies with no physical presence in the country. Austria's advertisement tax was introduced in 2000 and only took account of the then prevailing media such as print media, television, radio and billboards. The government's intention is to reduce the tax rate (currently 5%) of the advertisement tax but to simultaneously broaden the tax base to include online advertising so that the overall tax revenue from the advertisement tax remains the same.

This policy is part of a wider plan to tax the digital economy. Austria is also looking at other ways to bring internet companies within the tax net, for example by imposing VAT on online transactions or developing the concept of virtual PEs where a significant virtual presence exists.

Hungary

Hungary has adopted new legislation which increases the rate of its advertisement tax from 5.3% to 7.5% but retains the de minimis threshold at which the tax kicks in – despite the concerns of the European Commission that the measure gives companies with a low turnover 'an unfair economic advantage over competitors'. The increased tax rate came into effect on 1 July 2017. Although the advertisement tax does not specifically target the digital economy, it is considered to be influential in the operation of the digital market. The advertisement tax applies to media companies, including non-resident providers, in respect of publishing activities and advertising activities, including internet portals, at a fixed rate on tax bases over HUF 100m (approximately €321,000).

China

China has expressed its intention to be a global pioneer in international taxation, in particular in relation to the digital economy. To this end, the Chinese tax authorities have endeavoured to improve the tax administration environment, so as to provide a level playing field for companies in both the digital economy and the traditional economy. China has already made a number of changes to its tax framework, including new regulations, introduced in April 2016, that make e-commerce platforms responsible for collecting indirect taxes from online traders.

Although China's VAT law already imposes VAT obligations on online sales in the same way as any sale of goods through a bricks-and-mortar business, there are problems with enforcement. China is considering implementing a number of reforms on both the corporate income tax level and VAT level to address this. It is possible that China could implement a point-of-sale tax collection system to ensure that when customers buy goods online, the requisite VAT is diverted directly to the tax authority. China has also indicated its intention to adopt a revised PE concept. It is worth noting that the China-Chile tax treaty, which was signed in May 2015, includes all of the PE changes proposed by BEPS.

More specifically, the Ministry of Finance, the State Administration of Taxation and the General Administration of Customs jointly issued a notice in 2016 on the tax policy of cross-border retail e-commerce. According to the notice, the import of retail goods through e-commerce (i.e. business to consumer transactions) is subject to customs duty, VAT and consumption tax. The tax base is determined by reference to the price of the transaction, including the price of the goods, freight charges and insurance premiums; and the e-commerce enterprise, platform or logistics enterprise is to act as a withholding tax agent.

Saudi Arabia and Kuwait

Tax authorities in Saudi Arabia and Kuwait have introduced the concept of a 'virtual service PE', which is deemed to exist even with no physical presence in the countries. It is generally understood that such a virtual service PE would exist where a non-resident provides services to a consumer in Saudi Arabia and/or Kuwait over a period of time exceeding the threshold period under the applicable tax treaty. There remains the question of whether a tax treaty exemption will be respected or whether such a measure amounts to a treaty override. However, Saudi Arabia has confirmed that tax treaties will continue to take precedence. This new approach does not consider the physical presence of employees or contractors of a non-resident service provider for establishing the nexus to the source country. Consequently, any services performed for a period longer than the tax treaty threshold (e.g. 183 days) under cross-border agreements between a non-resident and consumers in Saudi Arabia and/or Kuwait will, prima facie, create a virtual service PE in Saudi Arabia and/or Kuwait. This will be created even if employees of the former are not present in these countries and perform their activities entirely offshore.

Furthermore, Saudi Arabia recently ratified the Gulf Cooperation Council (GCC) VAT framework and committed to introduce VAT on 1 January 2018. It is understood that Kuwait will follow suit by the end of 2018. This will be an opportunity for both countries to design a VAT system from scratch which operates to tax the digital economy. It is likely that the place of consumption rules will apply as per the GCC framework agreement, which would be in line with the OECD's destination based principle.

New Zealand

New Zealand has also extended the scope of its GST to digital 'remote' services provided offshore. In addition, there has been growing political and media pressure for New Zealand to follow the UK and Australia and introduce a DPT. While a DPT has not been ruled out, the incumbent New Zealand government has indicated that its preference would be to introduce a package of anti-avoidance measures to counter transfer pricing and PE avoidance. The government's position is that a DPT may produce adverse consequences for taxpayers and would 'chip away at the consistency, neutrality and relative simplicity of [New Zealand's] tax system from a global perspective'.

Taiwan

In 2017, Taiwan amended its VAT legislation so that all foreign businesses that supply digital services (e.g. video gaming, streaming, image downloads) to Taiwan residents have to register for VAT in Taiwan, file VAT returns and pay VAT to the Taiwan tax authorities. It is the responsibility of the digital service supplier to collect and remit the VAT.

More recently, on 2 January 2018, Taiwan's Ministry of Finance issued guidelines on changes to income tax rules for foreign companies without a fixed place of business in Taiwan that provide e-commerce services to consumers in Taiwan. Income generated by such companies from services with an economic nexus to Taiwan would be deemed to be Taiwan source income and could be taxable.

Turkey

Turkey enacted rules in 2016 that require internet service providers and internet advertising agencies (amongst others) acting as intermediaries in the country to submit information on a monthly basis about their transactions with Turkish customers (both individuals and companies). Under such rules, information on digital sales of goods and services, as well as payments in respect of internet advertising services, must be submitted to the Turkish tax authorities.

Turkey also introduced a withholding tax obligation in 2016 that encompasses payments made through e-business and other online activities. The Council of Ministers has authority to determine the extent of the withholding tax liability for parties or intermediaries involved in taxable transactions regardless of whether:

- the recipient of the payment is a taxpayer;
- taxpayers or intermediaries of the payments are obliged to withhold tax;
- the payment relates to the trading of goods or services;
- the transaction is digital; or
- the payment is deducted from the tax base.

The Council of Ministers also has authority to determine the withholding tax rates to be applied.

Alongside the withholding tax obligation, Turkey has introduced the concept of an 'electronic PE'. Based on the proposed definition of the electronic PE, intermediaries involved in the supply of goods and services and/or the collection of payment, as well as the purchasers of goods and services, could be severally liable for the payment of relevant withholding taxes.

More recently, like many other jurisdictions, Turkey extended the obligation to register and account for VAT to non-resident digital service suppliers. This came into effect on 1 January 2018.

Looking to the future

It is very clear from the discussion above that unilateral and inconsistent measures to tax the digital economy are being considered and implemented on a wide, global basis. This raises significant concerns regarding potential double taxation, increased administrative burden and uncertainty. Given that, as the CBI observes in its recent response to the UK position paper, the digital economy is fast becoming the whole economy, these issues could impact a large number of businesses. This places significant importance on the international efforts to agree a multilateral approach on this issue with a view to averting further unilateral action. All eyes are now on the OECD's Task Force on the Digital Economy and its interim report due to be presented at the meeting of the G20 finance ministers in April. ■

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- ▶ The royalties withholding tax consultation: non-UK UK source (Jeremy Cape & Bernhard Gilbey, 17.1.18)
- ▶ ECOFIN agrees EU approach on digital taxation (6.12.17)
- ▶ The EC's communication on digital taxation (Zoe Wyatt & Miles Dean, 5.10.17)
- ▶ OECD consults on digital economy (27.9.17)
- ▶ EU ministers discuss taxing digital giants (20.9.17)