
**Committee of Experts on International
Cooperation in Tax Matters**

Introduction

Digitalization has been stated to be the most significant development of the economy since

created, by whom and what that created value is, can all be subject to considerable differences of opinion.

6. Both these terms call for a generally accepted understanding when they are referenced, at least at a general level. The terms "digital economy" and "value creation" are not defined by the BEPS project in any detailed sense.⁴ For example, even though there is no definition of the digital economy, suggestions are proposed including the term, such

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distinct digital economy, but rather the global economy as a whole has been digitalized. Little effort has been made to start a discussion as to the definition, as in other international forums the term digital economy has pledged towards its natural meaning.

9. On the other hand, certainty could be enhanced if a definition is broadly accepted and sufficiently clear in its terms. A transparent dialogue to recognize the generally accepted principles and agree on the operational difficulties would convey greater clarity and the treaty negotiators will operate under more transparency.

10. Moreover, the main area of difficulty in defining value creation is that the technological features and digital business models constitute an illustration of integrated global value chains. Therefore, value creation and real economic activity concepts are not easy to identify.⁸ The definition of value creation has to contain elements key to the understanding of the term, such as where the value is created, how much value is created in between transactions, the consumers role in the process and the areas that are important to different players in the economy. Currently, there is a lack of explanation as to whether there is a difference between the concepts of value creation, substantial activity and economic activity.⁹ Different use of different terms could lead to unnecessary confusion. There is, then, a lack of consensus and guidance in understanding both the terminology of digital economy and value creation. Further efforts must be placed to reach a generally accepted definition, and to be transparent about any differences preventing such an agreement. The UN Tax Committee could play an important catalytic role in this.

11. Additionally, distinguishing the digital economy as distinct from the non-digital economy introduces the issue of



on the pros and cons is one that developing countries may want to have under the aegis of the United Nations, even if also discussed in other fora.

20. The Committee of Experts in International Tax Cooperation (Tax Committee) is widely regarded as the only body in the world where developed and developing countries have equal standing in the *development* of tax policy norms (which should not be confused with important, but differing, *norm-implementing* bodies). The Tax Committee would therefore be an environment capable of providing developing countries, and Least Developed Countries, in particular, with equal standing when analyzing issues related to the regulation of unilateral actions in view of the demands of the digital economy, and the re-rationalization of the concept of permanent establishment in light of those changes. Developing a set of rules that are fit for purpose for all nations is to the benefit of all stakeholders in tax systems.

21. This topic is timely, and should be discussed now in light of the unilateral measures introduced by countries across the world, and the likelihood of greater regional cooperation on these issues. These measures are only made possible due to the lack of a common international framework to regulate the distribution and allocation of taxing rights between countries. This paper does not attempt to include an exhaustive list of the existing measures. It merely

and where a UK company enters into intra-UK arrangements which results in an effective tax mismatch. A practical example would be when a foreign tax paid is less than 80 per cent of the UK tax saved. The main objective of the proposal was to counteract arrangements used by large companies that would otherwise erode the UK tax base. It has been dubbed the "Google Tax", as it was rumoured to be focussed on addressing large digital MNEs, however it has been applied in other cases¹⁹. The above legislation was not well received by the academia, the businesses and different international organizations due to the generic approach of the legislation. Australia

25. **Australia** has followed the UK in taxing aspects of the digital economy by re-designed domestic rules. They introduced the Multinational Anti-Avoidance Law, which took effect from the 1st of January 2016²⁰ although the Diverted Profits Tax operated only from July 2017. The legislatio

France

26 Consideration of the 2017-2018 Budget Law (Loi de Finances) and the introduction of corporate taxes on income generated in the market country, the redefinition of the digital economy including the unpaid nature of France

within that state that continue for more than six months. The traditional OECD understanding is that in order for a services PE to exist the work needs to be physically performed in the country for the specified period. However, the DZIT insists on the registration of a PE in Saudi Arabia if the total duration of a contract exceeds 6 months.²⁹ Under the DZIT no physical presence is required and that the only aspect that matters is the duration of the contract. The fact that the service is provided both inside and outside of Saudi Arabia is irrelevant, where the total contract exceeds the threshold of six months.

Israel

28. Israel also developed legislation to tax foreign companies providing services in **Israel** through the Internet. The Israeli legislation emphasizes that income of foreign digital providers of services and goods to Israeli residents should be taxed even if they have no physical presence in Israel under the "conventional rules" (referring to the [OECD BEPS action 1](#) (tax challenges of the digital economy)). An amendment to the VAT legislation was also under discussion according to the relevant governmental Circular. The proposal is to require non-resident suppliers of digital services to register and account for VAT in Israel. The above measure will target B2C (business to consumer) transactions, which supply digital services and are liable for VAT. The MNEs will have to account for such changes in the VAT even if they are selling only virtual content or providing Internet services to Israel customers.

China

29. China has been implementing reforms on both the corporate income tax level and the VAT level relating in particular to source taxation of the digital economy. The Ministry of Finance (MoF), the State Administration of Taxation (SAT) and the General Administration of Customs jointly issued a notice on 24 March 2016 (Cai Guang Shui

²⁹ Vladimir Gidirim, Taxation of Foreign Multinationals Enterprises Conducting Business in and with Saudi Arabia, Bulletin for International Taxation, April 2006

³⁰ Israel Tax Authority, Circular 4/2016 (available in Hebrew only)

³¹ I1u-24 88.11 354.65 Tm0 g0 G[(he)4()-59(MNEs)] TJET00.00000912 0 612 792 reW*ñBT/F3 8rCn24 Tm0 g0 G[(a)4(v)7(a)4(il)-3(a)4(b)-6

[2016] No. 18) concerning the tax policy on cross-border retail e-commerce. According to the notice, the import of retail goods through e-commerce (i.e. B2C transactions) is subject to border tax relief





Digital Business Models

38. Digital economy business models have substantial differences from the established brick-and-mortar retail model, therefore the planning opportunities in the digital space are utilized by technology companies in different ways. Firstly, the platform-based model is utilized by technology companies in different ways. Firstly, the platform-based model is simply create a platform, which connects sellers of goods or services to buyers and charges a fee for that service. The new business model is more efficient because it eliminates costly intermediaries. A digital company could potentially locate their key production factors anywhere and minimize their tax exposure in the source countries.⁴⁶ This marketplace could be used to connect advertisers to web pages, as well as connect service providers like drivers, landlords, housekeepers, nannies, cooks and also online products with or without physical presence to consumers. The value of the platform is on the viewership and the number of people using the app or website.

39. Technology companies that have been making headlines for their perceived tax structures are Google, Facebook, Amazon and Apple. Their response to criticism is often is that they are simply following the law of the countries and if countries need more source taxation they need to change the rules. The reason these rules are not relevant nowadays is the element of physical presence. The online business model is also likely to evolve over time and become more sophisticated. It is time to change the rules, as they are not fit for purpose anymore. It is appropriate that the new rules be forward looking and foresee some of the changes that are likely to be introduced in digital economy the years to come. The Committee might decide to introduce some changes in order to tackle the difficulties in the digital economy. These changes will be included in the tax treaty models. However, the fact that they are encompassed in the model does not suggest that they are automatically included in the bilateral treaties. The related parties still have the freedom of choice when deciding their international tax agreements.

⁴⁶S. Sim and M.J. Soo eds., *Asian Voices: BEPS and Beyond* (IBFD 2017) chapter 28

40. The main issues concerning the digital economy are (a) nexus, (b) data and (c) characterization.

(a) nexus

41. "Nexus" broadly

agenvPE cto øu rpi vj .⁴⁹ Substantial additional profits should not be expected under the MLI modifications. There are businesses that can remotely generate revenues without the need of physical presence or nexus in the source country.⁵⁰ As a result, the existing rules should perhaps be reformulated to consider taxing business profits in the country where revenues are generated from a good or service.⁵¹

(b) data

45. Moreover, the consistent application of the attribution of value to the use of data is unclear. Customer meetings comprise of product demonstrations and data driven presentations to persuade the customer of its need to have a product or service. Not all raw data have value, nevertheless, most of the data collected are extremely valuable, the main challenge is understanding how data are monetized. For example, an online gift platform could acquire data of the emails and date of births of customers. The way to monetize these data is to contact the customers closer to that date of

(c) characterization

47. Characterization of payments plays a vital role in the taxation of the digital economy. It is a challenging task to qualify payments as royalties, fees for technical services or business profits, each of which may be accorded very different treatment under treaty allocation rules. Furthermore, innovative parts of the new business models, such as 3D printing, are expected to further complicate the situation until precedents are in place.⁵² If nexus is established by the existence of a PE, business profits are taxed in the market jurisdiction applying the net principle, but royalties give rise to withholding taxes and payment are taxed on a gross basis. Net and gross taxation include major differences due to the fact that gross taxation does not inherently recognize the profit margins of a business. Neutrality could be affected if the gross taxation does not allow the business to be profitable as it might destroy the market especially for smaller, newer, entrepreneurial steps. Moreover, cloud computing creates a shift towards a service oriented model for hardware

argue against a necessary transparency of action ó as was the case in the past in relation to bank secrecy. Developing countries have been accused in the past of misuse of information, yet most tax õgcmö nowadays are initiated by whistle-blowers within taxpayers or their advisers and there is no empirical evidence that there is more risk involved when the developing countries are exposed to information. Confidentiality is important but a right to it is not limitless and it should it be used as an excuse to protect ones corporates from liability for not paying taxes abroad when due.

49. In the second stage of the proposals, the technical issues will be resolved, allowing different timetables for different participants, the treatment of international digital investments will be revolutionized and greater transparency will benefit the international tax ecosystem.

50. There is perhaps no clear rational in modern conditions for having a threshold for a company to be exposed in a country and to illustrate taxable presence. The valid explanations presented in pre-digitalization era were the administrative difficulties, packaged with a successful permanent establishment model; both of the above have vanished in the age of digitalization. Even if there was once a rationale to limiting source country taxation based on the principle that business profits are associated with the country where production factors of economic activities are located, which is highly debateable, it is now vital to consider whether information (or knowledge) is a new fifth factor of production in the recent advances in the area of e-commerce. Information (or knowledge) is in large part derived and produced in the source state.⁵⁵

⁵⁵ J.F. Bianco & R. Tomazela Santos, *A Change of Paradigm in International Tax Law: Article 7 of Tax Treaties and the Need To Resolve the Source versus Residence Dichotomy*, 70 Bull. Intl. Taxn. 3 (2016), Journals IBFD.

The UN Tax Committee and the Digital Economy

51. The United Nations Committee



A New Taxable Nexus Approach?

58. There are different ways to modify the PE threshold and some of them have been

define a digital PE for treaty purposes and to create a definition that will not be open to misuse. The new nexus PE designed for the digital economy could not be applied universally, as it is structured to tackle a specific sector where the current PE test is at a breaking point. There are many practical issues involved with the new nexus approach, such as the loss making position. However, discussing a proposal, which conveys that international taxation needs to be closely aligned with the economic reality is a step in the right direction.

62. Inspired by the BEPS discussion, there is another new proposal of a new PE nexus test based on three components:⁶⁵ a *de minimis* revenue threshold, a time threshold and one thousand monthly users existing in a county.

63. Clear objective tests are easy to administer (as long as pertinent facts can be established); unfortunately it is also easy to manipulate and avoid them for that reason the international tax models have historically aimed at avoiding *de minimis* rules. It is common to face *de minimis* rules in national legislation but their international application is perhaps more fraught. Moreover, having the one thousand monthly active users (MAU) threshold is a universal approach that may not create equity when the different sizes of population are taken into consideration. Furthermore, another suggestion could be to leave the MAU, the time and the *de minimis*

strong Internet network continuously expanding to reach more consumers on behalf of the digital MNEs, and the supplies

implementation of DBCFT.⁶⁶ However, there are dangers and uncertainties involved in implementing an unprecedented radical reform such as the DBCFT. The dangers involve the distinction of final products, the treatment of the financial services and the pressure the measure is going to bring for the creation of secondary markets. The debate on implementing a radical proposal with unique advantages and disadvantages is complicated, as the administration has to decide on fighting

69. There are different levels of digitization

71.

respond quick enough when there is a disagreement with the authorities. It is clear that

protection and security. The International Standards Organisation (ISO) is working on the effective growth of blockchain, in order to protect international standards and the integrity of the program.⁷³ The issue will be the extent to which ISO standards could guaranty the security and reliability of the blockchain.

80. Moreover, the lack of intermediary and the lack of key master creates a crucial problem, when the private key is lost there is a risk of the user being permanently locked out of the network. Additionally, there is an increased reliance on technical expertise, when the ps

