IFA seminar considers supplementary nexus as possible solution to digital taxation

Sophie Chatel, head of the OECD's tax treaties, Liz Chien, vice-president of global tax for Ripple Labs, and Conrad Turley, of KPMG, set out their arguments for the right way to tax digital businesses.

Sometimes an issue seizes the attention of tax professionals and it becomes the only one they want to talk about. That is in spite of everything else going on in tax policy and practice at that time. The topic of the day right now is the digital economy, or, as many refer to it, the digitalization of the economy. The EU, with its digital taxation package, and the OECD, which produced an interim report, have both grappled this year with the taxation of companies that mainly earn revenue through the use and exploitation of digital technology rather than from factories and other forms of traditional manufacturing.

Richard Vann, chairman of a seminar on non-traditional business presence at the International Fiscal Association's (IFA) annual congress in Seoul today, said the issue was about the desirability of a new form of taxable presence: "The debate is about whether the international tax rules should be modified to deal with digitalisation on a long-term basis with some other form of net basis taxation of profits. A virtual PE is not the only mechanism by which this can be achieved but, like clicks, is often used as a shorthand way to describe such solutions."

Four propositions

The seminar was set up as a debate between Conrad Turley, of KPMG in Beijing, who set out the arguments supporting four propositions (see below) that would lead to the creation of a so-called supplementary nexus rule, and Liz Chien, vice-president of global tax for Ripple Labs, who opposed the propositions.

Turley explained that some of the policy, threshold and allocation reasons for a supplementary nexus were based on ideas such as the role such companies had in the economy of a country, the contribution of users to value creation and the ability to obtain a return on capital. He spoke of the role of a company in a country's economy, the level of involvement of active users and country-specific investment as ways of gauging the threshold for taxation.

Intangibles crux

Chien contrasted the tax position of a company that used its brand intangibles to make money and one whose revenues were based on intangibles such as copyright. "It does not seem right that, for example, the revenue that BMW earns from selling vehicles in a showroom would be taxed differently from that earned from selling them online," she said.

It struck Chien that creating a new regime for the taxation of digital companies would look like ring-fencing, which went against the idea in the Base Erosion and Profit Shifting (BEPS) Project that the digital economy should not be treated separately. She said the companies that any new system would target

were mainly from the US, but there were some European and Chinese ones too, and that they all had physical presence of some kind, such as sales and business development people.

"Large profits come from large deals, which require human interaction, relationships and negotiation," she said, adding that the profit-split method used in transfer pricing already existed to deal with many of the issues related to the taxation of residual profits in a market.

Arguments that sought to include user activity as a threshold for taxation fell down, Chien said, for reasons such as the existence of fraudulent or multiple accounts, and the automation of user accounts with bots.

Consensus plea

Sophie Chatel, head of the OECD's tax treaties unit, stressed the need for a consensus among the 116 member countries of the BEPS Inclusive Framework on digital taxation. "Unilateral, uncoordinated measures in domestic law shows the need for consensus," she said. "We need to rally around one proposal. If treaty partners aren't together, this leads to double taxation." The OECD produced an interim report on the tax challenges of digitalization this year, with a view to producing a final report in two years' time. Today's discussion showed that reaching that consensus will not be easy.

Box

Proposition 1 – Policy: If a company does not have a physical presence in a country it should be taxed if it effects transactions with customers in that country by digital means and has substantial market share in the digital space for the kind of platform involved

Proposition 2 – Threshold: The threshold for taxing in no-physical-presence cases should be based on a combination of factors involving a monetary threshold, a clicks threshold and a measure of market share in the digital space for the kind of platform involved

Proposition 3 – Profit allocation: A portion of the profit derived from digital sales to customers in a country based on sales, users and/or nature of platform will be allocated to the country of the customers for net profits taxation

Proposition 4 – Implementation: The new rules should be implemented by a protocol to the MLI as a new international standard and peer reviewed for compliance in a similar way to the BEPS new minimum standards

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