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Agenda

1. Introduction
2. Background and European approaches to date
3. Asia Pacific approaches to date
4. The OECD’s latest proposals
5. Future timeline and prospects for agreement
6. Questions
How did we get here?
Taxation in the digitalised economy and beyond

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Overview

BEPS 1.0 – 2013-15
- 15 Action Items
- Source/residence left
- Tax value creation
- Action 1 conclusion:
  - Cannot ring-fence DE
  - Other BEPS solve

Dissatisfaction
- Digital Services Tax
- Rise of Unilateralism
- EU proposals failed
- US tech companies targeted
- US GILTI & BEAT

BEPS 2.0 - Feb 19 +
- Beyond arm’s length
- Tax residual profit
- Specific proposals beyond digitalisation
- Minimum tax proposals to fill remaining gap
OECD/G20 - BEPS Action 1

Perceived concerns

01
Scale without mass

02
User data, participation and networks

03
Reliance on intangibles
The views of countries can be categorized into three groups

**Group 1**
- User participation is value creation
- Targeted measures needed
- Otherwise maintain existing international framework

**Group 2**
- Digitalization challenges existing international framework
- Such challenges are not exclusive to DE

**Group 3**
- BEPS appears to be effective
- Full impact yet unknown
- Satisfied with existing framework
- No significant reforms
European digital services taxes: Challenges & initiatives

A DST has some characteristics of a direct tax

- Rationale: Taxation of profits where value is created
- Chargeability on a yearly basis (vs. per transaction)

Compatibility with tax treaties

- If the DST is a direct tax, within the scope of OECD Model Convention Article 2?
- Risks of double taxation and multiplication of MAPs

Compatibility with EU law

- EU based DST: could be contrary to primary EU law
- Unilateral DST:
  - Possible indirect discrimination based on nationality

### Table: European digital services taxes

<table>
<thead>
<tr>
<th>Country</th>
<th>Tax rate</th>
<th>Effective Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>Up to 5%</td>
<td>1 January 2019</td>
</tr>
<tr>
<td>Austria</td>
<td>3%</td>
<td>2020 (at the latest)</td>
</tr>
<tr>
<td>Italy</td>
<td>3%</td>
<td>30 June 2019</td>
</tr>
<tr>
<td>Spain</td>
<td>3%</td>
<td>TBC (government approved Jan 2019)</td>
</tr>
<tr>
<td>UK</td>
<td>2%</td>
<td>1 April 2020</td>
</tr>
</tbody>
</table>

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## (Interim) measures Asia Pacific

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Measure</th>
<th>Status</th>
<th>Key features</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>Equalisation levy</td>
<td>Currently applicable</td>
<td>Applies to digital services from overseas</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Tax collection from service recipient; platforms acting as a withholding agent</td>
</tr>
<tr>
<td></td>
<td>Significant economic presence</td>
<td>Legislative phase</td>
<td>Applies to overseas providers of digital services meeting local revenue thresholds / user thresholds</td>
</tr>
<tr>
<td>Taiwan</td>
<td>Income tax on digital services</td>
<td>Currently applicable</td>
<td>Income tax on digital services from overseas</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Net basis taxation with cost deduction, deemed profit ratio or contribution ratio</td>
</tr>
<tr>
<td></td>
<td>Diverted profits tax and anti-PE avoidance measures</td>
<td>Currently applicable</td>
<td>40% penalty tax rate for profits diverted offshore</td>
</tr>
<tr>
<td></td>
<td>Possible introduction of a digital services tax</td>
<td>Further consultation held in 2018</td>
<td>Limited to MNEs and intra-group transactions</td>
</tr>
<tr>
<td></td>
<td>Deemed permanent establishment</td>
<td>Policy discussion, which seems not to have progressed</td>
<td>Deeming a PE for overseas providers of digital services into Indonesia (or Thailand)</td>
</tr>
<tr>
<td></td>
<td>Digital tax</td>
<td>Policy discussion</td>
<td>Evaluating EU style Digital Services Tax and Diverted Profits Tax regimes</td>
</tr>
</tbody>
</table>

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Interim measures in ASPAC v OECD Consultation Document

— Will the (interim) measures adopted by individual jurisdictions be replaced by the proposed OECD measures, or will they supplement those measures?

— Will those countries contemplated digital services taxes as interim measures still proceed, pending longer-term OECD measures?

— Are the tax systems, tax administrations and dispute resolution mechanisms in Asia sufficiently able to adopt the proposed OECD measures?

— For MNCs headquartered in ASPAC, are their system data points and accounting systems able to capture the metrics necessary for implementing the proposed OECD measures?

— Is the rapid introduction of in-country measures increasing the risk of double taxation?
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OECD Policy Note - January 29, 2019

1st Pillar
Address Nexus & Profit Allocation issues

- User Contribution
- Market Intangibles
- Significant Economic Presence

Go beyond arm’s-length principle/
Affect larger group of MNEs

2nd Pillar
Address broader BEPS issues/Low taxation

- Income Inclusion Rule
- Tax on Base Eroding Payment
- Coordination Rules

Inspired by the U.S. tax reform/
Introduction of a withholding tax?

Accuracy & Tax Certainty
Simple & Administrable
Avoid Double Taxation

Recommendations on implementation of a LONG-TERM solution by the end of 2020
Five countries have played a leading role in putting forward four proposals

Marketing Intangibles
Market countries entitled to tax marketing profits regardless of where marketing IP is owned

Significant Economic Presence
Economic nexus with simplified profit attribution

User Participation
Economic nexus for businesses with significant user participation and profit attribution based on user engagement

Minimum Tax
Mechanism for residence and market countries to “tax back” low-taxed profits
Key design features

— Summary: Ring-fences identified digital business models
  - Tax challenges primarily manifest by business models with mobile IP and significant user participation
  - Governments identify business models within and outside of scope

— Nexus: Group-wide economic nexus, but only for targeted business models

— Profit attribution: How to quantify user contribution to value creation?
  - Traditional arm’s-length principle specifically rejected
  - Three-step approach: 1) residual profit; 2) profit split; 3) allocate profit to markets
  - Profit split – data-driven quantitative approach or formulaic?
  - Profit allocation – relative market revenue?

— Challenges:
  - Conformity for profit split and allocation
  - Reallocation of profits and dispute resolution mechanism
  - Could this solution withstand the “test of time”?
Allocate a portion of marketing profit to market countries regardless of ownership of marketing IP

Key design features

― Summary: Addresses tax challenges by allocating a share of marketing profit to market countries
  - No ring fencing – scope includes all businesses
  - Other income would be allocated based on existing transfer pricing principles

― Nexus: Economic nexus
  - E.g., Sales > $xxM in market = taxable presence

― Profit attribution: U.S. Treasury is advocating a modest approach
  - Modest – e.g., a percentage of in-market sales (dependent upon group profitability)
  - Disruptive – e.g., “Profit split” residual profit between marketing and product intangibles using public data

― Challenges:
  - Would modest profit attribution satisfy DST advocates?
  - A departure from the arm’s-length principle?
  - “Major surgery” to implement globally?
  - Implementation issues including application of arm’s length principle to remaining income
Significant Economic Presence

Economic nexus with simplified profit attribution

**Key design features**

- **Summary:** Reward market jurisdictions by abandoning residency-based nexus rules in favor of economic nexus
  - Not clear whether scope would “ring-fence” highly digital businesses
- **Nexus:** Significant economic presence (e.g., OECD 2015 AP1 Report)
  - Possibly targets highly digital businesses (see 2015 Report)
- **Profit attribution:** Formulary apportionment
  - Clear departure of arm’s-length principle
  - Tax base computed by multiplying market sales by group profit margin percentage – allocate based on apportionment factors
  - Goal is administerability and avoiding the complexities of arm’s-length profit attribution
- **Challenges:**
  - Equally weights profitability in each market
  - Is the world ready to abandon the arm’s-length principle?
Minimum Tax

Minimum tax supported by anti-base erosion measures

Key design features

— **Summary:** Remove incentives to avoid market nexus by shoring-up BEPS measures to address insufficiently-taxed profits of multinational enterprises
  - No ring fencing – scope includes all businesses
  - Two methods to “tax back” low-taxed profits – 1) CFC inclusion (e.g., U.S. GILTI) or 2) tax on base-eroding payments (e.g., U.S. BEAT)
— **Nexus:** Base erosion ‘tax-back’ rule requires treaty changes
  - But incentives to avoid permanent establishment may no longer be a factor
— **Tax base:** A priority rule is necessary to operate between the two ‘tax-back’ methods to avoid double taxation
  - CFC inclusion: the undertaxed CFC earnings with related FTC
    - Group-wide or country-by-country low-tax testing/inclusion?
  - Base-erosion tax: i) deny deduction or ii) deny treaty withholding tax benefits
— **Challenges:**
  - Would US GILTI constitute a “qualified” minimum tax regime?
  - Consensus on a “low-taxed” rate
  - Self-assessment vs. withholding tax and priority rules
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OECD Timeline

**G20 Mandate**
BEPS Inclusive Framework to prepare a report / Task Force on the Digital Economy

**OECD Policy Note**
Identification of 2 pillars & 4 approaches to be explored on a “without prejudice basis”

**Public Consultation**
To be held in Paris on March 13-14

**OECD Interim Report**
In-depth analysis of value creation across business models & identification of tax challenges

**Consultation Paper**
Responses required by March 1, 2019

**Update to the G20**
IF to agree on a detailed work program in May, with a view to reporting progress to G20 Finance Ministers in Japan

**Final Report**
Report on a long-term solution agreed by consensus, including recommendations

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Actions to Consider

**Awareness** – Educate the business and C-Suite that significant global tax change could be on the horizon again

**Quantify** – Look at how these changes could impact your business, and possible scenario analysis

**Engage** – Determine the right engagement strategy for you—from regular briefings to active engagement.

**Geopolitics** – Assist the business in understanding the implications of ‘failed consensus’
Your questions
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