Tax considerations in cloud computing
Global survey report
Cloud computing

is a technology megatrend that affects all industries, from technology companies as cloud service providers, to brick-and-mortar companies utilizing the cloud to reduce information technology (IT) and infrastructure costs. With the market for cloud computing services continually expanding globally, cloud service providers struggle over how to effectively manage the tax treatment of cloud-related operations. Similarly, taxing authorities grapple with applying existing tax principles to a business model that is often operated without respect to country borders.

In March 2012, Ernst & Young’s Global Technology Center conducted a survey of its Tax Advisory Panel (TAP) members to review the tax considerations related to providing cloud computing services in their respective countries. The countries reviewed included those in which cloud service providers most often conduct their operations. The survey requested information concerning taxable nexus, transfer pricing rules and requirements, withholding tax, value added tax (VAT), tax rulings, and advanced pricing agreement (APA) laws and procedures. The TAP members then provided a rating for their country based upon its tax environment.

Background

The survey was conducted assuming certain facts were present in the country under review. Specifically, the survey assumes that the provider of cloud services is organized in a foreign corporation (principal) that has substance, consisting of the following:

• Employees (including management, marketing and IT support)
• IT infrastructure for customer offerings
• Intellectual property (IP) rights (technology and marketing, owned or licensed) – along with bearing residual risk.

For most customers, contracts are entered into directly with the principal. In those cases, the principal will enter into contractual arrangements (subcontracts) with affiliates to provide IT infrastructure to operate the cloud and will also pay commissions to local sales/marketing affiliate(s). In other cases, contracts are entered into by local entities, in which case the principal acts as a high-value service provider for the local affiliate. In all cases, the principal engages the headquarters (HQ) group to provide marketing, management, research and development (R&D), and support services, and it engages other affiliates to provide R&D services. The infrastructure required to provide services includes servers located around the world; in most locations, these include both “smart” servers (core functions) and less sophisticated equipment that simply stores data or provides communications links (auxiliary functions).

The cloud computing matrix contains information regarding key jurisdictions, selected for their pervasiveness in global business operations. The focus is on PE, withholding tax, transfer pricing rules, and the availability of APAs and other rulings to mitigate and/or resolve all of those issues. The guide provides an overall rating of the country, phrased from the perspective of the provider of the cloud computing services. This information can serve as a reference for companies with global operations to rationalize their operations and to comply with applicable laws and be aware of local government practices that will affect their ability to optimally conduct business involving cloud computing services.
Summary of results

Certain trends emerged from the data upon review. In general, the results reflect that local tax laws have not evolved sufficiently to specifically address the taxation of cloud computing services, as the laws often predate the emergence and rise in popularity of cloud computing technologies.

Taxable nexus

- Many countries follow the Organisation of Economic Co-operation and Development (OECD) principles generally, which is especially true in the treaty context. Emerging markets tend to provide less certainty and/or express some opposition to the OECD Model.\(^2\)
- A simple majority of countries surveyed follow the OECD definition of dependent agent for taxable nexus.
- Generally, whether a taxable nexus exists is determined by weighing specific facts and circumstances. A minority of countries surveyed reported the mere presence of a server would likely constitute a taxable nexus for equipment, with many countries having an activity requirement.

Transfer pricing

- Again, many countries follow OECD principles in the area of transfer pricing.
- A number of countries allow for cost-plus markups for services.
- Currently, Singapore is the only country that offers a safe harbor markup percentage.
- Scrutiny around the characterization of income (i.e., services versus intangibles) is also highlighted for many countries.

Withholding taxes

- Characterization of income is essential to determine whether withholding taxes apply.
- Characterization also may dictate application of other business taxes.

Rulings/APAs

- Some form of an APA and/or ruling is available in all countries polled.
- Given the level of uncertainty present in most jurisdictions, many companies may prefer to obtain a ruling or APA until tax laws catch up to evolving business models.
- Hong Kong had APAs available starting in April 2012.

Overall country ratings

Six factors were considered in determining how individual countries were rated, relating to risk and tax law certainty when operating as a cloud computing services provider. Those factors include: risks of creating taxable nexus from the use of equipment located in-country, risks of creating taxable nexus from having people located in-country, the existence of transfer pricing rules applicable to cloud computing services, risks of creating withholding tax obligations based upon the character of income, risks of Value added taxes being assessed on the income, and the ability to obtain Rulings, APAs, etc.

- A “Green” rating signifies a low risk of creating adverse tax consequences based upon the factors considered.
- A “Yellow” rating signifies an increased risk that the factors considered could lead to adverse tax consequences; however, an existing treaty may mitigate the increased level of risk.
- A “Red” rating signifies a high risk that the factors considered could cause adverse tax consequences due to the lack of treaties and undeveloped tax laws.

<table>
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<th>Green</th>
<th>Yellow</th>
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<td>Singapore</td>
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Though some trends can be identified and guidance has been developed, numerous areas of tax law are open for further development. There are many open issues, such as whether the tax laws will be expanded to specifically capture fees for the use of servers and if PE laws will evolve to consider smart servers. As tax laws change and catch up with business models, companies will need to adapt their tax structures and compliance models accordingly. Businesses must keep apprised of the state of affairs for cloud computing in the countries where they conduct business.

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2. The OECD is an organization which works with governments to understand what drives economic, social and environmental change. It sets international standards on a wide range of issues, including tax policy.

3. The OECD Model is a model income tax treaty which provides a uniform template for countries to utilize in establishing income tax treaties with other countries.
Global cloud computing survey results
OECD model country

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</table>
| There are four requirements for a server to constitute a taxable nexus:  
1) Owned or leased  
2) Operated  
3) In a fixed location  
4) Performs core functions  
True service arrangements should not be an issue. Owning or leasing depends on nature of functions (core versus ancillary) and the definition of “operation” (see Taxable nexus – People). | Human interaction is not required to have a taxable nexus if computer equipment meets the four taxable nexus requirements, noted in Taxable nexus – Equipment. Dependent agents concluding contracts can also create a taxable nexus via computer equipment (provided that the activities of the dependent agent are not ancillary). | The OECD Model principles contain a preference for transactional methods over the profit split method. | Cloud computing generally involves business profits, so there is no withholding (because there is no source country taxation absent taxable nexus). | n/a | The OECD encourages establishing and actively promoting APA programs as a best practice. | n/a |
### China

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**China** is not a member of the OECD; however, some of the relevant interpretations on treaty articles issued by the China State Taxation Administration (SAT) use OECD rules as guidance. In practice, the taxable nexus assessment is up to the discretion of local tax authorities.

Under the general China tax treaty articles, the taxable nexus is generally the place of business. For example, if the business is conducted in China, the income attributable to that place is subject to Chinese CIT.

For example, if a Chinese entity undertakes only routine functions, with no high-value contributions pertaining thereto, the cost-plus method may apply. The Chinese tax authorities presently scrutinize the “routine entity” and may go into details to challenge the facts and substance for such a characterization.

In addition, both parties (the Chinese affiliate and the overseas principal) contribute significant value with respect to the provision of cloud computing services (i.e., the cloud computing services are mainly provided by the Chinese affiliate, with high-value services from the overseas principal), the profit split method or the IP pricing model may also be appropriate.

Further, please note that in China, it is difficult to make the remittance under non-trade name, i.e., intercompany services transaction. Even though the remittance may be successful, the deduction may still be challenged.

### Withholding tax

**Payment from local customers:** for a royalty fee, there is a 10% withholding tax under domestic law; limited treaties provide a reduction on withholding tax for a royalty fee. Withholding tax reduction for equipment rental is under certain treaties.

**In the case of a technical service fee,** generally, under treaty there is no withholding tax absent the creation of a taxable nexus. In practice, the Chinese tax authorities usually require very detailed documentation to support the no-PET argument, which, in practice, makes it difficult for taxpayers to fulfill. As the burden of proof lies on the taxpayer, it is common that the tax bureau would deem a taxable nexus to exist if the supporting documents are not to the tax bureau's satisfaction. In the case of a taxable nexus, the service income attributable to the taxable nexus would be subject to CIT.

When there is no treaty available, there is no CIT imposed if no place of business is created. Since China does not have clear regulations to define what constitutes a place of business, in practice, the determination may be subject to the interpretation of the local tax bureau, and the threshold may be lower than under tax treaty.

### Cross-border royalty contracts or service contracts should be registered with the relevant authorities in China. Generally, a taxpayer needs to register both if there is a taxable nexus and when there is no taxable nexus (herein, non-taxable nexus). The documents required to register a taxable nexus versus a non-taxable nexus are different. In practice, the registration asserting a non-taxable nexus is not common. Because of the lack of clear rules on the taxable nexus issue of servers and the uncertainties included in the categorization of a royalty versus a service fee, as well as the high value service charge, a case-specific ruling or an APA is generally recommended to seek confirmation and an assertion from the tax bureau.

In addition, China has strict foreign exchange control, and so to remit the actual fees overseas, the bank usually requires tax certification or exemption for each remittance.

**Red – After China’s CIT reform in 2008, China’s tax authorities have been more focused on the taxation of nonresident taxpayers and have issued many tax circulars on the topic since 2008, including circulars on treaty interpretations and taxable nexus. In practice, it is difficult to make a service fee remittance without withholding tax being paid, as local tax bureaus will arbitrarily argue that there is a taxable nexus to impose withholding tax.**
Germany is expected to follow OECD guidance in the treaty context. Outside of the treaty context, server presence is likely to create a German taxable nexus, if the server is owned (under certain circumstances, also in case of long-term leasing), which results in filing obligations. Any German-source income is subject to leasing), which results in filing obligations.

### Taxable nexus – Equipment

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<td>Germany tax treaties generally follow the OECD model principles with respect to offices and dependent agents.</td>
<td>In Germany, the standard methods under the service provider scenario should generally be applied. Those include the comparable uncontrolled price method, the resale price minus method, or, as a last alternative, the cost-plus method, usually in the range of a 5% to 15% markup. If the so-called standard methods cannot be applied, the transaction net margin method (TNMM) is applicable.</td>
<td>There is no guidance from the fiscal authorities yet regarding withholding tax in Germany. Basically, payments for the provision of cloud services should not trigger withholding tax. However, payments from German users or German local affiliates for cloud content have to be checked individually and might qualify as royalties (subject to withholding tax) for the use of software or rent for use of (movable) property in Germany.</td>
<td>Germany has different VAT rules for business-to-business transactions as opposed to business-to-consumer transactions. For business-to-business transactions, if the service provider is German, German VAT is invoiced and charged to German business customers. There is no German VAT charged from German service providers to foreign business customers. In the case of a business-to-business transaction where the service provider is established outside of Germany, no German VAT is invoiced or charged to the German business customer (reverse charge). For business-to-consumer transactions, when the service provider is German, German VAT is charged to German and other EU customers (until 31 December 2014). As of 1 January 2015, there will be German VAT for German customers and local EU VAT for EU customers. No German VAT is due for customers residing outside the EU (unaffected by the coming change in law). For business-to-consumer transactions with an EU service provider, EU VAT is charged to non-business customers that are residents of Germany or any other EU country. A new set of rules shall enter into force as of 1 January 2015 (in the VAT package). For business-to-consumer transactions with a third-country (i.e., not Germany or any other EU country) service provider, German VAT is invoiced and charged to German non-business customers. If business is conducted in more than one EU country, the Mini One Stop Shop Registration rule is available (securing VAT registration in just one member state), but VAT is still to be collected from various EU countries according to their respective local VAT laws.</td>
<td>APAs and rulings are generally available in Germany, but the process to obtain APAs and rulings is time-consuming and, for smaller matters, not feasible.</td>
<td>● Yellow</td>
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<td>Hong Kong is expected to follow OECD guidance in the treaty context for a taxable nexus regarding equipment. In the absence of a tax treaty, according to domestic legislation, the relevant questions to ask should be whether (1) the person carries on a business in Hong Kong and (2) the profits derived from such business are sourced in Hong Kong. The Hong Kong tax authorities generally hold the view that the mere presence of a server (without the involvement of human activities) does not amount to the carrying on of a business in Hong Kong. The tax authorities will look beyond the server and examine the extent of the taxpayer’s other operations to determine whether the taxpayer is carrying on business in Hong Kong. In addition, it is generally the location of the physical business operations, rather than the location of the server alone, that determines the locality of profits.</td>
<td>Hong Kong is expected to follow OECD guidance in the treaty context for a PE taxable nexus regarding people. In the absence of a tax treaty, according to domestic legislation, again (as in the analysis for PE: Taxable nexus – Equipment) the relevant questions to ask should be whether (1) the person carries on a business in Hong Kong (by itself or through an agent) and (2) the profits derived from such business are sourced in Hong Kong. To determine the source of profits, the Hong Kong tax authorities will generally look at what activity is done and where the physical operations are carried out by the taxpayer or its agent.</td>
<td>The transfer pricing principles applied in Hong Kong are generally consistent with the OECD Model guidelines. The Departmental Interpretation and Practice Note No. 46 (DIPN 46), which contains the Hong Kong Inland Revenue Department’s (IRD) guidelines on transfer pricing, provides for an arm’s-length principle. In terms of the application and preference of transfer pricing methods, the practice followed by the IRD generally will not differ from those recommended by the OECD. There is no hierarchy of preferred transfer pricing methods in Hong Kong.</td>
<td>Whether withholding tax would apply depends on the character of payment – that is, whether it is a payment for use of IP or simply a payment for a service or product. If the payment is made by the local customer to the overseas principal for a product or service (e.g., pre-packed or shrink-wrapped software) without the right to reproduce, modify, adapt or commercially exploit the copyrighted material, the payment generally would not be subject to withholding tax. However, if the local Hong Kong affiliates made a payment to the overseas principal for the right to commercially exploit the copyrighted material, the payment would be subject to withholding tax of 4.95% (or 16.5% if the IP has, at any time, been owned by a person carrying on business in Hong Kong). The Hong Kong treaty rate may be used where applicable.</td>
<td>There is no VAT in Hong Kong.</td>
<td>APAs have been available in Hong Kong since April 2012. The draft guidelines regarding APAs indicate that APA applications will likely apply only to bilateral or multilateral cases. This requirement for bilateral or multilateral cases to obtain an APA would require a double tax treaty to be in force. Hong Kong also has an advance tax ruling system to clarify the tax treatment of a contemplated arrangement.</td>
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India specifically in the context of e-commerce, expressed reservations on OECD guidance, consistently applied or recognized in India. The nature of the OECD Model guidance is not interpreting India's tax treaties. The binding courts have relied on OECD guidance in aligned with the OECD definition. Indian PE definition in India's tax treaties is largely based on the OECD Model Treaty as their basis. The fixed-place PE criteria both in the OECD Model Treaty and the UN Model Treaty are the same. However, the OECD guidance can be applied to determine whether a fixed-place PE is created for a principal or a place of business of a nonresident that is not an OECD member country and has only recently been granted "observer" status at the OECD. India's tax treaties typically have not an OECD member country and has only recently been granted "observer" status at the OECD. India's tax treaties contain the PE clause specifically providing that the securing of orders by a dependent agent for or on behalf of a nonresident would result in an agency taxable nexus.

Some of India's tax treaties contain the agency PE clause specifically providing that the securing of orders by a dependent agent for or on behalf of a nonresident would result in an agency taxable nexus. This concept is a significant extension of the agency PE clause, and the foreign enterprise could be regarded as having an agency PE in India merely by a dependent agent soliciting orders for the foreign enterprise.

India's tax treaties contain a service PE clause. A PE can be created for a foreign enterprise if employees or other personnel are present to provide services, and their presence exceeds specified time thresholds (including lower time thresholds where services are provided to associated enterprises).

India's tax treaties contain a service PE clause. A service PE is created when a foreign enterprise has personnel in India for a continuous period of time, whether in India or abroad. However, when the India-based servers are remotely related to the care operations of a principal, a no-business connection position could be explored. Although the OECD guidelines are not directly applicable to India, the Indian courts have relied on OECD guidance in interpreting India's tax treaties. The binding nature of the OECD Model guidance is not consistently applied or recognized in India. India, as an observer at the OECD, has expressed reservations on OECD guidance, specifically in the context of e-commerce transactions.

Indian transfer pricing regulations are generally based on OECD transfer pricing guidelines. Indian transfer pricing regulations prescribe the following methods for determining the arm's-length price: (a) comparable uncontrolled price method, (b) resale price method, (c) cost-plus method, (d) profit split method, and (e) transactional net margin method. The choice of the most appropriate method is a factual determination. Services such as R&D, marketing and technical services – in particular those that an Indian subsidiary or branch of a multinational company renders to its overseas affiliates – are scrutinized to see whether the compensation that the Indian subsidiary or branch receives is adequate.

In many cases, the Indian tax authorities decide that an Indian subsidiary or branch is not compensated at an arm’s-length basis for the services rendered and that it has given commercial or economic advantage to the service recipient, in which case adjustments are made. Withholding tax is applicable on payments to nonresidents that are taxable in India. Thus, withholding tax typically would be applicable where the payment is classified as a royalty or fee for technical service or business profits, upon the finding of existence of a PE or business connection in India. The direct tax laws contain a broad definition of "royalty," including the equipment royalty clause. Under this clause, payments made by local customers for use of the equipment royalty clause. As a result, the equipment royalty clause.

Some of India's tax treaties have defined "royalty" as payments for the use or right to use or services, and the equipment royalty clause. Under this clause, payments made by local customers for the use of tangible assets, the payment is classified as royalty payments. Some of India's tax treaties have established a more restricted definition of royalty by specifically excluding such a clause. In such a scenario, it is possible to adopt a no-royalty position under the corresponding tax treaty.

India's tax authorities are known to characterize fees for services that involve the use of technology payments as royalty payments on the basis that such fees are linked to the equipment for which royalty payments are being made.

The applicable service tax (VAT on services) is 10.3% on the import of a wide array of services, including leasing arrangements. For those services to which the VAT applies, the service tax is payable by the importer of service, under a reverse charge mechanism, and when the servers are located in India, it is possible to adopt a no-royalty position under the corresponding tax treaty. The applicability of VAT, a state-specific tax that can range from 5% to 13.5%, in the context of leasing must be evaluated based on the nature of the arrangement.

India presently does not have a system of APAs. However, the option of obtaining a private ruling to achieve tax certainty in India can be explored on certain matters, including the following: (a) characterization of income from the provision of cloud services, (b) existence of a taxable nexus in India, and (c) principles on income attribution.
### Ireland

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<td>Ireland generally follows OECD Model guidance regarding the definition of a taxable nexus. As a practical matter, Ireland’s low tax rate means that there is often little practical concern about creating an Irish taxable nexus. It is anticipated that, where there is a risk that an Irish service provider may constitute a taxable nexus of the foreign principal, an advance ruling may be obtained confirming that filings are not required for the principal, provided that the service provider is remunerated on an arm’s-length basis.</td>
<td>Ireland’s treaties generally follow the OECD Model for a taxable nexus regarding people. Irish domestic law has a potentially lower threshold for creating a taxable presence, viewed in strict technical terms; yet, Irish Revenue guidance suggests that a server without human presence is less likely to create a taxable nexus in practice. Comments in relation to taxable nexus – Equipment and the practical approach of securing a ruling equally apply with respect to a taxable nexus regarding people.</td>
<td>Irish transfer pricing rules codify the OECD guidelines into Irish law.</td>
<td>Ireland does not impose a domestic withholding tax on technical services. Royalty withholding tax applies to a narrow sphere of royalties. The terms of the contractual arrangement are key, but the general position is that cloud services itself should not subject one to Irish withholding tax liability.</td>
<td>The contractual terms are key for assessing the place of supply for VAT purposes (i.e., the obligation to account for Irish or foreign VAT) and implications for the registration obligation of a foreign principal in Ireland.</td>
<td>Earlier comments apply, insofar as they discuss the ability to secure advance rulings that a taxable nexus will not apply where arm’s-length pricing is applied. VAT rulings confirming the Irish VAT analysis are also available. Where Ireland is the principal, rulings are also available confirming the application of the low Irish 12.5% tax rate to the principal’s profits. These rulings can also extend to confirming that foreign IP companies will not be regarded as within the scope of Irish tax (either on income or in respect of the location of assets for capital gains purposes). Ireland has an informal APA program, wherein, generally, entrance to the program requires significant scale and confirmation that the tax authority in the other country is supportive of the APA.</td>
<td>Green – taxable nexus exposure is usually limited to cost-plus and can often be avoided through securing advance rulings. Generally, there is no withholding tax on service payments, and royalty withholding tax would not apply to most cloud payments. Ireland presents an attractive location for cloud principals, with a 12.5% tax rate and the ability to structure with a 0% tax rate for nonresident Irish IP companies. It is also important to note that Ireland has low relative operating costs and a strong track record of significant investment in cloud infrastructure by leading global players (including Microsoft, Google and Amazon).</td>
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Ireland
### Taxable nexus – Equipment

There is no clear guideline under Japanese tax law on the requirements for a server to constitute a taxable nexus in Japan.

In the treaty context, a judicial court may refer to the OECD Model Commentary as authoritative guidance in the interpretation of the treaty for certain cases, but the Japanese tax authorities may have a different view.

### Taxable nexus – People

The threshold for a dependent agent to constitute a taxable nexus under Japanese tax law is generally lower than that in the Japanese treaty context.

Much like a taxable nexus regarding equipment, a judicial court may refer to the OECD Model Commentary as authoritative guidance in interpreting the treaty for a taxable nexus regarding people, but the Japanese tax authorities may differ.

### Transfer pricing

Japan’s transfer pricing guidance on services does not provide direct guidance on cloud computing services. Guidance notes that if intangibles are used to provide services, the examiner may evaluate the type and quantum of effect the intangibles have on the services.

### Withholding tax

There are no clear guidelines under Japanese tax law as to characterization of income derived from cloud computing services. Guidance notes that if the services are provided in Japan, while they are not subject to withholding tax if provided outside of Japan, in the treaty context, payments for such services are generally characterized as business income.

Royalties are subject to a 20% withholding tax under Japanese tax law, but withholding tax may be reduced under the applicable tax treaty.

### Value added tax

Services are generally subject to Japanese consumption tax (VAT) if the services are provided within Japan. However, there are no clear guidelines addressing how to determine the location where cloud computing services are provided.

### Rulings, APAs, etc.

APAs are available in Japan. There is also potential administrative guidance provided in pre-filing meetings. In Japan, pre-filing meetings may be conducted on a named or anonymous basis.

### Overall rating

Yellow (Note: Rating could move toward Red depending upon taxable nexus controversy developments in Japan).
## Netherlands

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<td>The domestic taxable nexus definition and the PE definition under the Dutch tax treaties generally follow the OECD Model. The Dutch tax authorities by and large follow the OECD Model Commentary as well. In the absence of domestic guidance or case law, the OECD Model Commentary regarding e-commerce is the most reliable source for guidance. A taxable nexus may exist in the case that a website is an automated sales platform (smart server) and where the activities performed through the server cannot be considered preparatory or auxiliary.</td>
<td>The domestic and treaty definition of agency taxable nexus generally follows the OECD Model guidance and Commentary, whereby the Netherlands often applies a substance-over-form determination. Dependent agents concluding contracts can, therefore, create a dependent agent taxable nexus, even absent of a “fixed taxable nexus,” via computer equipment (provided that the activities of the dependent agent are not ancillary).</td>
<td>There is no specific guidance on transfer pricing in the Netherlands but the country tends to follow the OECD Transfer Pricing Guidelines and report on allocation of profits to a taxable nexus. With respect to the later Decree of 15 January, 2011, the Deputy Minister of Finance's position is that, even if a treaty does not contain the latest version of Article 7 of the OECD Model Tax Convention (MTC), the Netherlands is willing to apply the guidance of the OECD taxable nexus report if done consisently at both ends of dealing.</td>
<td>The Netherlands does not have withholding tax.</td>
<td>In the Netherlands, a fixed establishment for VAT requires a sufficient degree of permanence and human and technical resources to receive or supply services. If a fixed establishment is recognized, VAT taxable input and output supplies could be attributed to the fixed establishment as being purchases or sales made by the fixed establishment.</td>
<td>In the Netherlands, APAs are available with respect to the profit allocation to a Dutch taxable nexus. Advance Tax Rulings (ATRs) are available in the Netherlands with respect to whether the activities constitute a taxable nexus in the Netherlands.</td>
<td>Green</td>
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<td><strong>Central contracts are distinguishable from local contracts. The difference is that with central contracts, only one entity and country has VAT obligations and liability, whereas with local contracts, each local entity has VAT obligations and liabilities. Further, even with central contracts, there is the risk of attribution of VAT purchases and supplies to a fixed establishment. Under EU case law, even affiliate companies are considered to constitute a fixed establishment. Economic reality may prevail in these cases, such as in determining who is actually using or who is actually performing with respect to the supply. That is to say, legal contracts are relevant, but economic reality also is important. Payment flows and methods are essential for VAT, as it has been the experience of Ernst &amp; Young Belastingadviseurs LLP that there might be double VAT cases where payment runs through telecom operators.</strong></td>
<td><strong>In the Netherlands, a fixed establishment for VAT requires a sufficient degree of permanence and human and technical resources to receive or supply services. If a fixed establishment is recognized, VAT taxable input and output supplies could be attributed to the fixed establishment as being purchases or sales made by the fixed establishment.</strong></td>
<td><strong>In the Netherlands, APAs are available with respect to the profit allocation to a Dutch taxable nexus. Advance Tax Rulings (ATRs) are available in the Netherlands with respect to whether the activities constitute a taxable nexus in the Netherlands.</strong></td>
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Singapore

Taxable nexus — Equipment

Singapore does not have specific tax legislation governing cloud computing service providers; the general tax principles apply. Generally, the “operations test” is used to determine whether income is derived in Singapore. One must examine the business model and extent of operations to determine whether the income is liable to tax in Singapore.

The Singapore tax authorities have indicated in their e-commerce guide that the mere presence of a physical server in Singapore will not amount to trading in Singapore and that the extent of business activities in Singapore must be examined. This clarification serves to highlight that the server is not the only factor in considering the tax implications in Singapore.

As Singapore is not a member of the OECD, the OECD commentaries are used only as a reference for purposes of interpreting tax treaties.

Taxable nexus — People

In Singapore, the facts and circumstances of the case are analyzed to ascertain whether the activities of the employees of a foreign enterprise could expose the foreign enterprise to tax in the local jurisdiction.

Further, Singapore has a taxable nexus provision whereby a person shall be deemed to have a taxable nexus in Singapore if that person has another person acting on that first person’s behalf in Singapore who:

- Has and habitually exercises an authority to conclude contracts
- Maintains a stock of goods or merchandise for the purpose of delivery on behalf of that person or
- Habitually secures orders wholly or almost wholly for that person or for such other enterprises as controlled by that person.

Essentially, one has to consider the extent of the business operations carried out in Singapore (including the presence of personnel) to determine whether there is any tax exposure in Singapore.

Transfer pricing

Singapore’s transfer pricing guidelines are generally consistent with the OECD’s, and S34D of the Singapore Income Tax Act provides for the arm’s-length principle.

A circular on related-party loans and services was released by the Singapore tax authorities in 2009, which provides for a safe harbor provision of cost plus 5% on “routine” services. However, this is limited to the routine services listed in the circular, which are mainly corporate support services such as accounting, audit, database administration, etc.

Withholding tax

Singapore’s tax authorities have clarified that payments for cloud computing services constitute service payments. Such payments to nonresidents for services rendered in Singapore will be subject to Singapore withholding tax unless reduced by a tax treaty. Any payments for cloud computing services rendered outside of Singapore to nonresidents will not be subject to Singapore withholding tax.

On 16 April 2012, Inland Revenue Authority of Singapore (IRAS) issued a consultation paper that proposed adopting of a rights-based approach to characterize software payments and payments for the use of information and digitized goods. While the details of income characterization within the consultation paper are still to be finalized, this is a welcomed development to provide more clarity.

Value added tax

Singapore goods and services tax (GST) implications should be considered if there is a Singapore affiliate or if a principal has a business or fixed establishment, such as a branch or agency, in Singapore.

Rulings, APAs, etc.

APAs are available in Singapore. However, Singapore does not have a comprehensive tax treaty with the US, so only unilateral APAs are available if the counterparty to the related-party transaction is a US resident.

The Singapore Economic Development Board is focused on the cloud, social media and internet sectors with the aim of competing as the Asia-Pacific central hub for those activities.

Overall rating

Yellow — End users that incur cloud computing services (together with acquisition and leasing of prescribed automated equipment) may qualify for an enhanced tax deduction (i.e., up to 400% on the first $400,000), subject to meeting certain conditions.

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<tr>
<td>Switzerland follows the OECD Model country standard regarding its definition of a taxable nexus regarding equipment.</td>
<td>Switzerland follows the OECD Model country standard regarding its definition of a taxable nexus regarding people.</td>
<td>There are no special rules for transfer pricing in Switzerland; the best method is the practice.</td>
<td>There is no withholding tax under Swiss domestic law.</td>
<td>Services are subject to VAT.</td>
<td>Rulings are common practice and easy to obtain for cost-plus confirmation. APAs are also possible.</td>
<td>Green</td>
</tr>
</tbody>
</table>

Switzerland
Her Majesty's Revenue & Customs (HMRC) has stated that a server (either alone or together with websites) does not constitute a taxable nexus of a business that is conducting e-commerce through a website on the server. This view is consistent whether the server is owned, rented or otherwise at the disposal of the business.

There is less guidance outside of traditional e-commerce. If a company is providing services to its customers, hosted on servers located in the UK, and the activities hosted on the UK server are more than “auxiliary and preparatory;” the server could constitute a taxable nexus. It is necessary to consider the functions carried on by the server in the context of the overall business model.

If the server is merely providing hosting of software for use by local customers, profits attributable to the taxable nexus may be relatively low, compared with the situation where the activities carried on by the server represent a significant part of the value chain.

**United Kingdom**

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<tr>
<td>UK domestic law and treaties generally follow the OECD Model with respect to offices and dependent agent PEs.</td>
<td></td>
<td>UK law follows OECD guidance on transfer pricing.</td>
<td>The UK has withholding tax of 20% on certain royalty payments made from UK corporate taxpayers unless reduced by the relevant treaty or EU royalties directive as implemented in UK law. Note that most treaties and EU royalties directive implementation include anti-conduit rules.</td>
<td>A business must register for UK VAT if it is supplying or receiving taxable goods and/or services in the UK totaling more than £73,000 per year (with limited exceptions). This is the case even if the business has no place of business in the UK – in which case, it is required to register for VAT as a non-established taxable person (NETP).</td>
<td>It is possible to apply for an APA to obtain certainty on the transfer pricing adopted. An APA will commonly include provisions that the profits recognized in the UK are sufficient to cover all profits arising as a result of UK activities, including those that could be attributed to a taxable nexus.</td>
<td>Yellow – A treaty is required.</td>
</tr>
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<td>Her Majesty’s Revenue &amp; Customs (HMRC) has stated that a server (either alone or together with websites) does not constitute a taxable nexus of a business that is conducting e-commerce through a website on the server. This view is consistent whether the server is owned, rented or otherwise at the disposal of the business.</td>
<td></td>
<td>Generally speaking, profit split methodologies are rarely applied. But the HMRC may argue that profit split is the most appropriate method if there is limited involvement of people in the supply chain. OECD guidelines on profit attribution to branches are followed by the UK. It is possible to enter into an APA to obtain certainty over transfer pricing methodology.</td>
<td>The UK withholding tax requirement is dependent on the characterization of the payment – whether it is a payment in respect of patents or copyright or certain other IPR or whether it is a payment for services. Withholding tax is likely to be required on software licenses paid by corporate customers to a non-UK resident principal but not on payments for services provided by the recipient. Similarly, if a UK master distributor pays a related non-UK party for rights to distribute software, withholding tax is likely to apply but should not apply to payment for services.</td>
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<td>UK law follows OECD guidance on transfer pricing. Generally speaking, profit split methodologies are rarely applied. But the HMRC may argue that profit split is the most appropriate method if there is limited involvement of people in the supply chain. OECD guidelines on profit attribution to branches are followed by the UK. It is possible to enter into an APA to obtain certainty over transfer pricing methodology.</td>
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### United States

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<td>The US is expected to follow OECD guidance in the treaty context; accordingly, direct server ownership may be acceptable in the case of ancillary functions but is not advisable. One open issue is the interpretation of the “operation” prong when server management is subcontracted; whether remote or onsite operation includes activities of contractors, all agents, only agents with contractual authority or employees is unclear. Outside of the treaty context, server presence creates a significant rise of US trade or business, which results in the creation of a filing obligation and subjects any US-source income to net corporate tax.</td>
<td>US treaties generally follow the OECD Model with respect to creating taxable nexus from offices and dependent agents. Domestic law has a similar (but potentially lower) standard for US offices. The US trade or business standard, which triggers the filing requirement and taxable income in the event of US-source income, simply requires regular, substantial and continuous presence but does not require fixed physical presence (direct or via agent). Agent activity without contractual authority may create a US trade or business.</td>
<td>Treasury Regulation §1.482-9 provides specific methods to apply to services, including the cost method for certain back-office services (which may be applicable in certain cloud models). The US transfer pricing rules note that IP pricing models may be appropriate in certain circumstances.</td>
<td>There is a risk that withholding tax could be imposed on payments from US users and, potentially, non-US users, to the extent that services are performed in the US (or to the extent that payment is treated as a royalty or rent for use of property in the US). Foreign-source services income is not subject to withholding. For non-US users, service fees are considered to be paid to the principal if services are outsourced to a US affiliate or third party.</td>
<td>There is no VAT in the US; however, many states and local governments impose sales and use taxes.</td>
<td>APAs are available in the US. Potential administrative guidance, such as a prefiling agreement, may be available on character, source and taxable nexus issues.</td>
<td>Red – Particularly if a principal is not in a treaty jurisdiction. The US has expansive, effectively connected income rules because of the force of attraction principle (all US source business income is attributable to any US trade or business).</td>
</tr>
</tbody>
</table>
Closing thoughts

Though some trends can be identified and guidance has been developed, many areas of tax law remain open for further development. Open issues include whether the tax laws will be expanded to specifically capture fees for the use of servers and whether taxable nexus laws will evolve to consider smart servers. With ever-expanding international markets and technological advances, cloud computing is an area to follow on the global level. The OECD Model provides guidance upon which many countries base their cloud computing policies, but the variances from one country to the next and within each country over time require that companies stay informed to make effective business decisions. As tax laws evolve and catch up with business models, companies will need to adapt their tax structures and compliance models. Accordingly, it is essential that businesses keep apprised of the state of affairs for cloud computing in the countries where they conduct business.

For further information contact your local Ernst & Young office.

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