Managing indirect taxes in the digital age

Digital: disruptive business or business disruption?
The sharing economy: disruptive business or business disruption?

Digital is transforming business models. “Digital intermediaries” are enabling online connections on a previously unforeseeable scale between people who want to share their belongings and people who want use them. As a result, businesses involved in the new “sharing economy” have grown from local start-ups to well-known multinationals almost overnight, disrupting many traditional business sectors and attracting high levels of attention from the media, regulators and tax administrations.

These new disruptive businesses are providing local tax authorities and legislators with quite the headache. In many cases, their new and unfamiliar business models seemingly conflict with existing tax legislation and business regulations. The disruptive companies themselves are, however, also struggling. While barely keeping pace with their rapid growth, they are confronted with an endless array of uncertainties not only in the regulatory domain but also in the field of tax.
Key indirect tax issues

One of the main indirect tax issues arising from the sharing economy follows from the very nature of the business concept involved. The sharing economy can largely be defined as peer-to-peer lending against consideration. In most countries, a broad definition of a VAT/GST taxable person applies that covers all persons and entities that, independently, carry out a supply against consideration on a regular basis.

As a result, peer-to-peer lenders will often qualify as VAT/GST taxable persons in respect of their peer-to-peer supplies. Many lenders are, however, not yet sufficiently aware of this fact nor of their resulting VAT/GST obligations. Consequently, these businesses are often not VAT/GST registered, do not meet local indirect tax compliance requirements (e.g., issuing of invoices) and, perhaps most importantly, do not collect and remit VAT to the local authorities. Small business regimes may apply, but these are often also subject to formalities. Similarly, as the lenders generally do not perform their supplies on a “professional basis” they may lack specific (regulatory) licenses required to carry on certain types of business.

In turn, the compliance issues that apply to the peer-to-peer lenders also have an impact on the digital intermediaries. As a result, these intermediaries are not only involved in their own indirect tax issues but also in the issues related to the parties they are connecting, e.g., if they prepare the invoices on behalf of the lenders.

Disruptive businesses also face these issues

Besides the issues outlined in this section, disruptive businesses involved in the sharing economy generally also face several other issues, some of which may also have a significant impact on the indirect tax position of companies concerned:

▸ Regulatory license requirements
  As many peer-to-peer lenders do not carry on their activities on a ‘professional basis’ they may be unaware of or even unwilling to obtain any specific regulatory licenses required for performing their activities. This lack of knowledge or compliance causes significant troubles for the digital intermediary companies whose platforms they use, as they may be considered to be facilitating illegal services. Assuming that the services are not strictly forbidden, VAT/GST legislation should still apply. However, it may be that specific rules (such as the application of a reduced rate or an exemption) do not apply due to the absence of a license. This may also impact the margin of the digital intermediary companies, which generally receive a fixed percentage of the income earned by the lenders.

▸ Deemed employment
  So far, digital intermediaries have taken the position that the peer-to-peer lenders performing supplies via their platform are independent parties and not employees. This position, however, is currently being challenged by groups of lenders in multiple countries. If the lenders must be considered to be employees of the digital intermediaries, this will have a significant impact from a VAT/GST perspective as well as from the perspective of direct taxation.

▸ Data privacy
  In conducting their sharing platforms, digital intermediaries are connecting large groups of private individuals from whom they collect personal data in order to process transactions. Protecting this personal data is a major concern and an issue that can have a severe impact on corporate reputation, as has become clear in the news media in recent years. This data is also of particular interest to tax authorities, as it may help them to identify peer-to-peer lenders who are not paying taxes (in some cases, unknowingly but in many cases deliberately).

▸ Foreign exchange (FX) restrictions
  FX restrictions are a common issue for many international businesses. Due to the centralized set-up used by many digital intermediaries and their limited local activity, these concerns are particularly important, especially, for digital intermediaries that are directly involved in the collection of cash for the supply performed by the peer-to-peer lender on his behalf. Where cash collection is not an option, the business model may require careful consideration.
Key indirect tax issues in the sharing economy

The main indirect tax issues in the sharing economy include...

Qualification of the supply
A digital intermediary generally receives a commission for every peer-to-peer supply established via its platforms. Although many countries have defined what qualifies as an electronic service for the purpose of establishing the place of supply, many countries also have specific place of supply rules for other services such as intermediary services. These two sets of rules may not be aligned. As a result, questions arise as to which rule takes precedence. Additionally, some countries will want to consider the digital intermediaries as undisclosed agents, whereby from a VAT/GST perspective, the agent is considered to first purchase the supply of the peer-to-peer lender before supplying it onward to the buyer. Different interpretations applied by different countries may lead to a number of consequences, e.g., they may trigger a requirement for the intermediary to register for VAT or they lead to double or non-taxation. Multinational digital intermediaries, in particular, need to deal with these issues and may want to limit uncertainty in this difficult legislative landscape.

Proof of customer status
In most countries, the status of the customer (i.e., is it VAT/GST taxable or not) influences the place of supply. Most peer-to-peer lenders generally qualify as VAT/GST taxable persons in respect of their peer-to-peer supplies. However, currently, many peer-to-peer lenders are not VAT/GST registered (or are not yet registered) as they are unaware or are unwilling to do so. This may lead to a number of compliance issues for the digital intermediaries who deal with them for example, they cannot include a VAT/GST number on their invoice, report these supplies in sales listings etc. It may also be that the digital intermediaries find it difficult to prove to the tax authorities that their customers do or do not qualify as VAT/GST taxable persons. These issues call for a careful review of the supply chain and of the legislation to avoid issues with the tax authorities.

VAT/GST liability
Many peer-to-peer lenders do not pay-in VAT/GST or meet the general compliance requirements (e.g., issuing of invoices). In many countries, local tax authorities are currently assessing how this issue can be resolved. In this respect, multiple questions arise, such as:

- To what extent are the digital intermediaries involved in the supply as performed by the lenders?
- Can the digital intermediaries be held liable to pay-in the VAT/GST due on the supplies performed by the lenders?
- Is it possible for the digital intermediaries to willingly take on the liability of the lenders and free them from their obligations (although existing legislation does not provide for this)?
- Can the digital intermediaries be held jointly and severally liable for any VAT/GST due on their supply to the lenders if the latter do not pay-in VAT/GST (under a reverse charge)?
- Are the digital intermediaries assisting in fraud by facilitating the supplies of the lenders when they know they do not charge and remit VAT/GST on their supplies?
- Are the digital intermediaries assisting in fraud by applying a reverse charge on their supply to lenders when they know they do not charge and remit VAT/GST on their supplies?

To deal with all these questions, the digital intermediary requires in-depth knowledge of the local legislation, controversy support and potential mediation with the local tax authorities to obtain rulings, often in multiple countries. As this issue is inherent to the sharing economy, and it occurs on a large scale and is hard to tackle, it seems unlikely to be resolved in the short term.

Assuring third-party compliance
Digital intermediaries are entirely dependent for their success on the services that third parties offer via their platforms, i.e., the peer-to-peer lenders. Due to their disruptive business models and visible public presence, the activities of digital intermediaries are hotly debated in news media in many countries. Hence, from a commercial perspective, effectively digital intermediaries are forced to ascertain that the parties that they are connecting are acting in compliance with the law. From a VAT/GST perspective this generally means that these parties must be registered for VAT/GST, issue invoices, charge VAT/GST, file reports and pay VAT/GST collected to the authorities. To ensure this compliance, digital intermediaries are consequently forced to actively inform their peer-to-peer lenders about their obligations. Moreover, from a commercial perspective, to ascertain that compliance does not hamper growth, digital intermediaries often also look to take on some of the compliance obligations of the lenders (e.g., third-party electronic billing and self-billing). These issues require a full tax analysis of the activities of the lenders in jurisdictions where they operate: for example, if any registration thresholds apply, if there are any small business
Multiple tax audits

The sharing economy and its business models are still largely unfamiliar to many tax authorities. At the same time, in many parts of the world, news media have claimed that VAT/GST is being avoided by peer-to-peer lenders, prompting tax authorities have decided to take action. In doing so, they have often turned their attention to the digital intermediaries involved. This tactic is perhaps understandable: the peer-to-peer lenders are many and hard to audit (as they may not be known to the authorities due to the absence of a VAT/GST registration), while the digital intermediary companies are few and they are very well known! As a result, tax audits are routinely performed on the digital intermediaries and they may even take the form of high-profile “VAT/GST raids.” Furthermore, these audit actions may be carried out by tax authorities in different countries simultaneously. Therefore, digital intermediary companies need to be aware of the likelihood of multiple local VAT/GST audits and actively prepare for them – not only by properly arranging their audit files but also by having an up-to-date controversy strategy and a team that is ready to assist them whenever and wherever they need.

Fixed establishment

An electronic service for VAT/GST purposes is in many countries defined along the lines of a supply that is essentially automated, or involves only minimal human intervention. Technology allows digital intermediaries to generally operate their services (i.e., facilitating an electronic market platform) from across the globe. Currently, the most well-known digital intermediaries have head offices in the US, Europe or both. However, in addition, minimal local human presence is often also required in the countries where these intermediaries operate their platforms; this is generally due to the fact that the peer-to-peer lenders themselves are generally not professional businesses and some onboarding assistance may be required. In these circumstances, questions may arise as to what is being done locally versus from afar and how essential this assistance is for the underlying supplies. Some countries may consider this local presence as a permanent establishment (PE) for corporate income tax purposes or even a fixed establishment for VAT/GST (FE). This may significantly impact the VAT/GST treatment of certain supplies, such as for the service fee charged by the digital intermediaries to the local lenders. As in many countries the services of the digital intermediaries are currently untaxed (as peer-to-peer lenders do not account for reverse charge VAT on these supplies), there is a potential increased risk that local authorities will argue for the existence of a FE. Accordingly, digital intermediaries must carefully set-up their business structures and be aware of potential PE or FE pitfalls.

Loyalty programs and incentives

To enable rapid growth in new markets, digital intermediaries generally make extensive use of incentives and loyalty programs. As is the case for any business, setting up of each of these incentives and programs requires careful research from a VAT/GST perspective. Particular care is needed if borrowers are able to connect to lenders all over the world. Certain incentives or programs may not be feasible in certain countries, for example, because they will trigger a local registration requirement or increase the VAT taxable base.
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Indirect taxes, ranging from value-added tax (VAT) and customs duties to environmental levies, affect the supply chain and the financial system. They pose unique challenges to multinational tax functions since they must be managed accurately and in real time. These often invisible taxes can have significant impacts — on cash flow, absolute costs and risk exposures.

Thanks to our network of dedicated Indirect Tax professionals, who share knowledge and ideas, we can provide seamless, consistent service throughout the world and help you deal effectively with cross-border issues. These include advising on the VAT treatment of new and complex transactions and supplies, and helping resolve classification or other disputes and issues with the authorities.

We provide assistance in identifying risk areas and sustainable planning opportunities for indirect taxes throughout the tax life cycle. We can provide you with effective processes to help improve your day-to-day reporting for indirect tax, reducing attribution errors and costs, and making certain indirect taxes are handled correctly.

We can support full or partial VAT compliance outsourcing, help identify the right partial exemption method and review accounting systems. Our customs and international trade teams can help you manage customs declarations, audit and review product classifications, and evaluate import and export documentation. Our globally integrated teams can give you the perspective and support you need to manage indirect taxes effectively.

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