The taxation of the digital economy - an integrated EY Tax approach

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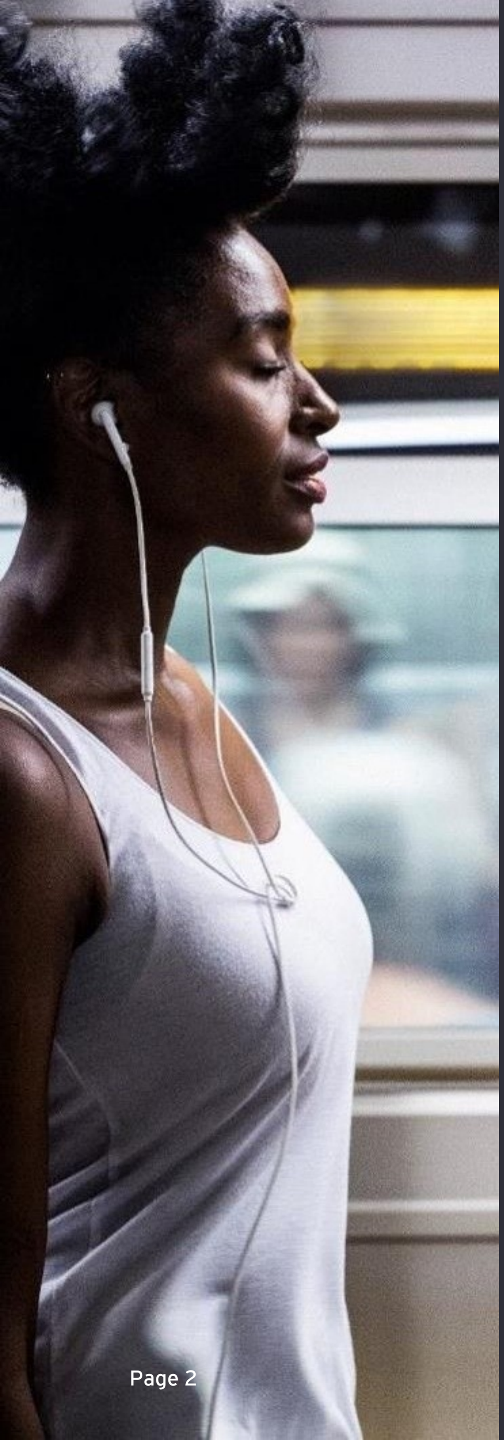

Background

Since 2015 and the release of the original base erosion and profit shifting (BEPS) reports, the taxation of the digital economy has been a complex and constantly evolving issue for taxpayers and governments. Taxing digital activity involves multiple overlapping disciplines of taxation including VATs, customs duties, sales and use taxes, and traditional income taxes. Income tax considerations are further complicated by legislative change to expand nexus for existing taxes to capture cross-border online and digital transactions. Taxpayers and governments continue to debate issues concerning to whom these taxes should apply, ranging from companies to individual consumers and in both the business-to-business (B2B) and business-to-consumer (B2C) contexts - resulting in challenges, controversy, and uncertainty.

Further complicating the landscape, all of this has occurred against the global backdrop of the new rules relating to the original BEPS project to address concerns about stateless income, unfair tax competition, transfer pricing challenges and insufficient transparency.

These new rules impact companies in the digital/technology sectors through mechanisms such as "diverted profits taxes" (e.g., in UK and Australia), extra-territorial taxation of intangible property income (e.g., UK Offshore Receipts in respect of Intangible Property (ORIP) and US Global Intangible Low Taxed Income (GILTI)), and the India Equalization Levy. At the same time, the US Supreme Court decision in the Wayfair case has resulted in new obligations with respect to the collection of sales and use taxes for online sales in the United States. While all these new rules are potentially applicable to all taxpayers, they are in response to an increasingly digital global economy and they are disproportionally applicable to the technology and digital sectors.

While new policies advanced with a broad international consensus following the release of the 2015 BEPS reports, Action 1 of the BEPS project (Addressing the Tax Challenges of the Digital Economy) did not yield agreed solutions as desired by the governments seeking specific tax policy changes for core digital economy companies. As a result, the European Union (EU) and specific countries began to implement one of the original proposals under Action 1 – revenue-based Digital Services Taxes (DSTs) on specific digital economy transactions. Focusing on particular online business models, the originally proposed DSTs targeted certain activities such as advertising, platforms and data monetization and provided motivation to the OECD and its members to continue work on Action 1. This led to the launch of the now active BEPS 2.0 project, which aims to re-configure the entire international landscape of taxation through its Pillar 1 and Pillar 2 elements.

As progress on BEPS 2.0 advanced from 2019 into 2020, the world has been impacted by the COVID-19 pandemic and countries have begun to seek new sources of revenue. As a result, we are seeing a proliferation of new DSTs and similar taxes on the digital economy as the interest in these sources of revenue has overtaken progress toward development of fundamental reforms to the international tax architecture under BEPS 2.0 on a consensus basis. These new taxes include DSTs of the type originally proposed plus, in certain jurisdictions, greatly expanded DSTs that apply to virtually all digital transactions.

As such, they are adding to a confusing matrix of VATs, customs duties, DSTs, levies, withholding taxes, extra-territorial taxes, and hybrid digital transaction taxes. We expect this scope and jurisdictional expansion trend to continue.

Finally, this rapidly evolving digital taxation landscape also poses risks to companies in traditional industry sectors such as financial services, transportation, and retail, and other tech-converged organizations where digital transformation is a key strategy for growth – thus making understanding the taxation of the digital economy an imperative for most organizations.

EY Response

Working across our core international, indirect, global compliance and reporting, and policy tax practices. The EY organization has assembled a team across the global with participants in all impacted jurisdictions to assist EY clients in doing the following:

- Discerning, interpreting and applying the full range of digital taxes (both direct and indirect) that are relevant to their technology and digital supply chains including assessing whether exceptions may apply.
- Assisting clients to resolve uncertainties in the administrative application of the new laws.
- Quantifying the amount of anticipated taxation in relevant jurisdictions and, if and where required, managing compliance with the new taxes and filing the required reporting forms.
- Keeping current with the global policy landscape in this area and, as appropriate, participating in the debate with the relevant stakeholders to help shape the future policy with respect to the taxation of the digital economy.
- Understanding the impact of taxes on digital economy transactions on the company's overall tax profile, including direct and indirect cash and tax rate computations as well as considerations related to financial statement presentation.

Specifically, EY teams can assist with the following insights and tools:

- EY Digital Tax Policy Forum: Subscribe (opt in) to the mailing list for timely email updates on local and global developments from our EY Global Tax leadership team.
- Indirect Tax: We can assist taxpayers in assessing the entirety of their potential tax burden on digital economy transactions and help them distinguish among digital taxes including VATs on electronically supplied services, sales and uses taxes on digital economy transactions, new and emerging DSTs, and so-called hybrid taxes (e.g., the Indian Equalization Levy) and customs duty impacts of BEPS Pillar 1 activities, retaliation measures for DSTs and consideration of potential dutiability of electronic cross border transactions as well as nexus expansion changes in local country laws that capture VAT or corporate income taxation on transactions that are effectuated digitally.

  EY teams have the following tools available:

  - The EY Global Digital Taxation Summary, which provides an overview of Digital Services Taxes (DSTs) as well as new, hybrid applications of existing taxes on purely digital transactions. Please connect with your EY account teams for a jurisdictional summary of active DSTs.
  - The EY DST Analyzer tool to analyze, qualify and quantify the application of existing and new, emerging Digital Taxes.

- International Tax and Transaction Services (ITTS): EY teams can assist taxpayers in assessing the cross border and extra-territorial impact of digital economy taxes, including whether certain taxes may be credible against other taxes as well as how they may interact with current withholding taxes and emerging extra-territorial taxes related to intangible property (IP) such as the UK ORIP, the US GILTI and FDII regimes and other similar tax laws. We can also assist with considerations such as planning, controversy, supply chain structuring, related IP alignment and valuation issues, acquisition due diligence, planning and structuring, as well as the financial statement considerations of the application of the range of potentially applicable digital economy taxes.
- BEPS 2.0 Modeling: EY teams have developed Pillar 1 and Pillar 2 modeling tools to estimate the impacts of the OECD Inclusive Framework's proposals.
- Tax Policy: EY teams can assist taxpayers in understanding the current and future global tax policy trends on the taxation of the digital economy, including understanding the economic impact of COVID-19 on local country tax policies (click here for our Global Stimulus Tracker) for the digital economy and the ongoing BEPS 2.0 debate under Pillars 1 and 2. We can also assist taxpayers in staying abreast of future developments and participating in the global tax policy debate on digital taxation. For more information, please click here.

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Your business will only succeed if you build it on a strong foundation and grow it in a sustainable way. At EY, we believe that managing your tax obligations responsibly and proactively can make a critical difference. Our 50,000 talented tax professionals, in more than 150 countries, give you technical knowledge, business experience, consistency and an unwavering commitment to quality service – wherever you are and whatever tax services you need.

BMC Agency
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