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Global Tax **INSIGHT**

SPECIAL ISSUE – Taxation of the Digital Economy:

- The OECD's approach
- The French Digital Services Tax
- US GILTI rules and the G7 response
- US proposed regulations on digital content transactions
- The UK's proposed Digital Services Tax
- The Spanish Digital Tax
- Australia and the digital economy

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An overview of this issue

Taxation of the Digital Economy

How much is the "fair share" of tax that digital businesses should pay? That question is at the forefront of tax policy changes.

We are at a turning point as increasing numbers of jurisdictions consider imposing local taxation on the provision of digital services by overseas providers. Indeed, we have seen a number of jurisdictions that have either already introduced a digital services tax of some kind or are about to do so. That involves some fundamental changes to the global tax system and those are possibly more seismic even than some of the recent BEPS (aka Base Erosion and Profit Shifting) changes. Those taxes are still in their infancy and much remains to be decided and learned. The future of direction of travel though will greatly depend on whether the OECD can create a more globally joined-up system (see the first two articles below). Until then, we can expect the existing patchwork of new regimes to proliferate. Some of those new regimes and their impacts are discussed below.

This is an evolving area. Feel free to contact your usual Ashurst contact or any of the authors should you wish to discuss further.

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GLOBAL

TAXATION OF THE DIGITAL ECONOMY

by Paul Miller and Nicholas Gardner

The key issue here is the taxation of cross-border flows and profits. In particular, when should jurisdiction A subject an entity from jurisdiction B to tax on the profits attributable to jurisdiction A? And if jurisdiction A does seek to exercise such taxing rights, what is the right measure of "local" profits on which to impose tax?

Those two questions are at the very heart of the current attempts to reshape the global tax system.

Although the proposals for change currently under consideration ostensibly relate to the digital economy, this begs the wider question of where the boundaries – if any - of the digital economy lie.

It may help to consider the current position so as to understand the context for the current system and the perceived issues with it.

INSIGHTS

- **New business models enable companies to generate income in jurisdictions in which they have little physical presence; this is not catered for under current 'nexus' tests.**
- **Value can be created by consumers or users of a digital service as well as the supplier but there are differing views on the extent to which this should be recognised and taxed, and how it could be measured.**
- **There are international projects addressing these questions. In the meantime, many jurisdictions have initiated their own solutions either by way of direct tax changes or extensions to VAT/GST sales taxes.**
- **Multinational businesses should keep abreast of developments in this area.**

Common Principles of Global Taxation

While each country has its own rules, there are some common principles that pervade the global tax system. Those principles evolved in the days before the internet and underpin the current global tax system. Back then, it was relatively difficult to sell overseas without having "boots on the ground" (or in tax-speak a "permanent establishment"). So a system evolved where jurisdiction A would not seek to tax profits of overseas entities unless they had a "permanent establishment" in jurisdiction A. However that nexus test has not kept up with changes to the way in which business is done. In particular, new business models enable companies to generate significant income in a given jurisdiction with little or no physical presence (and thus no permanent establishment and little or no local tax).

The other major theme governing the global tax system is that, at least currently and hugely over-simplifying, profits are generally taxed where value is created rather than where customers are located. That in turn led to the development of the so-called "arm's length principle". That principle requires affiliates to charge each other arm's length prices for the services they provide. That is a sensible starting point but can lead to the design of supply chains where the services provided in high tax jurisdictions are minimised (for example, so-called "limited risk distributors").

There has also increasingly been public criticism of a system that allows global digital businesses to pay fairly low effective rates of tax in many of the foreign markets in which they operate.

Reshaping that system and the answers to the two questions above are now firmly on the radar in every major jurisdiction.

Effecting change

There is widespread recognition that an approach which is relatively consistent globally has a range of benefits to both business and governments. The Organisation for Economic Development (OECD) which is a group aiming at improving global trade, has put itself at the centre of that discussion.

It has already recommended a large number of other changes to the global tax system through the so-called Base Erosion and Profit Shifting (BEPS) project. That project, in effect, parked the two questions above insofar as they relate to digital businesses but they are now firmly at the forefront of the international tax agenda.

A number of governments, for example those of Germany, Switzerland, Canada and Sweden, have made public announcements that they have no plans to implement an interim tax on digital services and are awaiting global consensus.

However, many others are losing patience with the search for consensus on these issues and are initiating their own solutions, some by way of direct taxes and others by extending their indirect VAT or GST rules.

For example, France, India and Italy have already amended existing rules or enacted specific direct digital services taxes, with the UK, South Korea, Spain, Poland, Austria and the Czech Republic being among those with new direct tax laws in the pipeline. Australia and South Korea have extended or introduced their indirect tax regimes to cover digital services along with a huge number of other jurisdictions which have or will do similar (sometimes in conjunction with a proposal for a direct tax on digital services).

There is a very real danger, therefore, of a patchwork of similar taxes - overlapping in some areas and leaving gaps in others - undermining the OECD's attempts to create a more globally cohesive and fair tax system.

What can businesses do?

It is more important than ever for any business undertaking cross-border activities, whether obviously within the digital sphere or not, to be aware of new taxes on the horizon and to begin assessing the application of them to their business and their potential impact.

Where possible, businesses should look to add their voices to any consultations or other opportunities to input into the design of these measures to ensure that the key issues are considered by the policy makers.

In the UK, that process is relatively transparent with clear time frames and contact details for engaging with HM Revenue & Customs while the draft legislation is being consulted upon. Similarly, in the US, the period for comment on proposed regulations on digital content transactions runs until 12 November 2019. It is less clear what stakeholders in Spain can do, since proposals there are in abeyance pending governmental change. Similarly, the BEAT and GILTI rules in the US, and the new French and Australian rules are all past the point of inviting comment.

The introduction of new measures almost always throws up unexpected consequences, all the more so where there are multiple interactions across borders. Whatever degree of involvement businesses choose to take at this stage, these changes cannot be ignored for long. And we have not even touched upon the raft of VAT and GST proposals out there. These would require another longer publication.

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GLOBAL

The OECD's approach

by Paul Miller, Nicholas Gardner and Vicky Brown

Pushing for a consensus solution

The OECD – in the form of a multijurisdictional task force involving 134 member countries – is working towards a long term, comprehensive, consensus-based solution to tax challenges arising from increased digitalisation of the economy, which it hopes to be in a position to deliver by the end of 2020.

Building on previous discussion documents, including a detailed programme of work, on 9 October 2019 the OECD Secretariat published for comment a proposed new approach (the "Secretariat Proposal") to the fundamental questions of where tax should be paid (the so-called "nexus" rules) and on what portion of profits they should be taxed ("profit allocation" rules). A similar consultation will take place in November and December 2019 in respect of a proposed global minimum tax, allowing jurisdictions to effectively charge a "top up" tax on group profits that would otherwise be subject to a low effective rate of tax.

These proposals are expressly designed to increase the tax actually paid by larger cross-border businesses as well as redistributing taxes paid to "market jurisdictions", that is the jurisdictions in which consumers of the goods or services in question are based. It is recognised that high-income economies would not benefit to the same degree as low and middle-income economies, while certain investment hubs would experience significant losses in their tax bases. There is a question, therefore, as to whether there is sufficient international political will to finalise and implement these proposals.

Nonetheless, the OECD has a positive record of obtaining political engagement under the BEPS Project, and the spectre of businesses having to cope with

numerous uncoordinated and unilateral measures in the jurisdictions in which they earn revenues, coupled with an associated increase in tax disputes, may also be sufficient to persuade governments to engage with these proposals

If these OECD proposals are actually implemented by governments, they would represent the most seminal changes for many decades to the way in which larger cross-border businesses are taxed, dwarfing even the recent BEPS changes.

Two pillars emerge

The OECD has identified two "pillars" on which its proposed solution to taxation of the digital economy would rest.

1. Pillar One focuses on profit allocation and nexus rules.
2. Pillar Two focuses on the remaining BEPS issues and seeks to develop rules that would provide jurisdictions with the right to charge a "top up" tax where other jurisdictions have not exercised their primary taxing rights or the payment is otherwise subject to low levels of effective taxation.

INSIGHTS

- **The OECD is undertaking a review of profit allocation and nexus rules, considering user participation in value creation, the role of intangibles and where significant economic presence is found.**
- **The current base proposal is for a "top up" tax, which would involve a denial of deductions or additional source-based tax and granting treaty benefits only to payment flows already subject to a minimum rate of tax.**
- **If this proposal can be broadly agreed then, as with the BEPS initiative, implementation would need changes to domestic legislation and probably treaty change via another "multilateral instrument".**

1. Allocation of taxing rights

The OECD's programme of work, published in May 2019, contemplated a reform of profit allocation rules based around three alternative approaches: user participation, marketing intangibles and significant economic presence in the sense of a purposeful and sustained interaction with a jurisdiction.

Further work on the May 2019 proposals was not progressing as the OECD had hoped and, mindful of its commitment to deliver a solution in 2020, the OECD Secretariat published the Secretariat Proposal based on common elements in the proposals in an attempt to accelerate progress. This consultation does not therefore represent an emerging consensus amongst the OECD member countries but can nonetheless be viewed as an important step forward.

Nexus

The heart of the October 2019 Secretariat Proposal is a new nexus and profit allocation rule. That is needed to reflect the impact of the digital economy, with businesses often now able to avoid a physical presence through the use of existing and emerging technologies to enable remote participation. This has been particularly prevalent in the provision of search engines, and the online gaming, adtech, social media and digital marketplace sectors.

The OECD proposes introducing a nexus rule applicable wherever a business has a "sustained and significant involvement in the economy of a jurisdiction", such as through consumer interaction and engagement. It is suggested that a revenue threshold in the market (adapted appropriately to the size of the market) could be the primary indicator of such involvement. It would apply to all business models, whether making remote sales directly to consumers or selling in the market through a distributor.

It is anticipated that this new nexus rule would operate in conjunction with the existing permanent establishment rules.

Allocation methodology

A new nexus rule requires new profit allocation rules; it would be a nonsense to apply existing treaty provisions relating to location of functions, risks and assets in order to allocate profits to a jurisdiction where none of these attributes exist.

The OECD Secretariat suggests a three tier mechanism for taxing the market jurisdiction profits of in-scope businesses. Those tiers are named Amount A, B and C. It is Amount A which is the radical part of this proposal.

> **Amount A** that part of a group's deemed "residual profit" (i.e. that profit remaining after allocating what would be regarded as a deemed "routine" profit on activities to the countries where the activities are performed) which would be subject to the taxing right for market jurisdictions created under new nexus and profit allocation rules.

In short, this has been designed to allocate the group's deemed "residual profits" between the jurisdictions into which the group sells. Whilst that may be a useful response to the current perceived issues with the system, the practical question of how to calculate these "residual profits" is not addressed in much detail by the October 2019 OECD paper.

The details, such as they are, are in appendix 1 which provides a four step approach for determining the Amount A to be subject to the new taxing right.

1. Identify the group profits, probably from the consolidated financial statements and potentially determined on a business line and/or regional/ market basis to avoid distortive effects;
2. Exclude remuneration for routine functions based on an agreed level of profitability. In the interests of certainty, this would be an approximation, possibly based on a fixed percentage which may vary depending on the industry or business line;
3. Determine what proportion of non-routine profits are attributable to the market jurisdiction rather than other factors such as trade intangibles, capital and risk. Again this would be calculated using a simplifying convention such as an agreed percentage;
4. Allocate the resulting Amount A among eligible market jurisdictions in accordance with a key based on variables such as sales.

Amount B baseline marketing and distribution functions that take place in the market jurisdiction could be taxed under existing transfer pricing rules, but the consultation appears to prefer the certainty of fixed remuneration for these activities, reflecting appropriate and negotiated fixed returns (potentially varying by industry or region).

Amount C any additional profit where the marketing and distributions activities taking place in the market jurisdiction exceed the baseline activity compensated under Amount B. Such profits would need to be supported using the arm's length principle.

Clearly a number of issues still require significant amounts of work and decisions on the best way forward. The need for further detail is particularly apparent in the four step process for determining Amount A and the way in which "deemed residual" profits will be calculated, but the interaction of Amounts A, B and C is also an area with the potential to cause numerous disputes if not delineated carefully.

The use of simplifying conventions or fixed percentages to approximate profit attribution should address a large number of concerns about the difficulties in valuing the relative contributions to profit of factors, particularly value created by users, but appropriate levels will still need to be agreed internationally.

Scope

It is suggested that businesses in scope would be widely defined, e.g. as businesses that generate revenue from supplying consumer products or providing digital services that have a consumer-facing element. Some sectors, for example extractive industries and commodities are expected to be carved out. Importantly, the Secretariat envisages further discussion on the possibility of the financial services sector also being carved out of scope.

A €750m revenue threshold is mooted as a size limitation, in common with the Country-by-country reporting requirements and, indeed, many of the unilateral digital services taxes or proposals, such as those in France, Spain and Italy.

Administration

The proposals indicate that determinations may need to be made at the business line level if the rules differentiate between particular types of business and if different percentages are used in the simplifying conventions. However, basing the new taxing right on business line figures could lead to disproportionate difficulties for the taxpayers in extracting the necessary data from entity information as well as being harder for tax authorities to police. Appropriate materiality thresholds and exclusions may be necessary in addition to the simplifying conventions if the rules are not to be unworkable or overly prone to disputes.

Compliance, collection and enforcement arrangements must all be designed and a withholding tax is still not ruled out provided it does not lead to double taxation. New reporting and exchange of information obligations will arise, although it is fair to say that the existing framework and technology used for the exchange of country-by-country reports should be adaptable for this purpose.

The introduction of these rules pushes up against the same issues encountered by the initial BEPS Project recommendations and minimum standards; it is acknowledged that these further measures are likely to need another multilateral instrument (MLI) to modify existing international agreements, as well as domestic implementing rules.

2. Global Anti-Base Erosion

The second pillar of the OECD's proposal is based on the concern that a risk of profit shifting to low tax jurisdictions remains, despite all the other BEPS Project initiatives, especially in the context of intangible property – on which digital businesses rely particularly heavily, such as the rich user data that can be derived from digital engagement.

The OECD proposal is broadly for a "top up" tax so that a minimum level of tax is paid, bolstered by provisions allowing the source jurisdiction to protect itself against base eroding payments. More specifically:

- The minimum tax would be imposed on a shareholder's proportionate share of an entity's income if it hadn't already been taxed at a minimum rate. Similar in concept to controlled foreign company (CFC) rules, this proposal is intended to supplement, rather than replace, such rules.

  As with many CFC rules, the OECD suggests that only substantial shareholders should be affected, say, those holding over 25%. The tax base would broadly be determined by reference to the rules applicable in the shareholder jurisdiction, but the preference is to "top up" to a fixed percentage rather than a rate related to that in the shareholder jurisdiction. This has the advantage, it is said, of being both simpler and better for maintaining the desired level playing field between jurisdictions.

- The proposal in relation to a tax on base eroding payments envisages:
  - a denial of deductions or additional source-based tax (possibly including withholding tax) for related party payments where that payment was not subject to tax at a minimum rate (the "undertaxed payments rule"); and
  - a "subject to tax" rule in treaties that would only grant certain treaty benefits, e.g. reduced or eliminated withholding taxes on dividends, interest or royalties, if the item of income was subject to tax at a minimum rate. This rule may apply only to related party payments but could be extended in some circumstances to payments between unconnected parties.

While various simplifications are being incorporated or at least investigated further (for example, the use of accountancy rules in determining the tax base to be subject to the "top up" tax), these new proposals inevitably introduce yet another layer of complexity into tax calculations. However, if international agreement cannot be reached on these multilateral measures, the alternative is likely to be a mishmash of domestic rules which would need to be considered concurrently and would likely result in a level of uncertainty and risk of double taxation. Our understanding is that the concept of the "top up" tax is gaining support amongst the OECD members.

Dispute resolution

Vital to the introduction of any new rules affecting cross-border taxation is the existence of a prompt and effective dispute resolution mechanism. This is particularly the case when allocating value to an activity or market jurisdiction, bearing in mind the lack of consensus of where or if value is created by users and/or consumers. However, it is also relevant to any part of the new rules which is not purely based on existing business data.

The OECD recognises this at various points in the public consultation document and working programme and has given responsibility for investigating this area to Working Party 1, which generally has responsibility for treaty developments. The fundamental question will be whether existing dispute resolution procedures are sufficiently effective; whether these need improvement or whether new dispute resolution measures need be developed.

Next steps

The Secretariat Proposal on Pillar One is open for comment until 12 November 2019, immediately after which there will be a public consultation meeting with a view to the OECD member countries reaching agreement on an outline approach at their meeting in January 2020.

Similarly, a public consultation document is expected to be released on Pillar Two issues in early November 2019. The OECD hopes that they will be in a position to agree the main features of this at the January 2020 meeting, with political agreement on the remainder by the middle of the year.

Running in tandem with this work will be an economic analysis and impact assessment of the proposals. The OECD say that they recognise that it is important that any measures imposed are not disproportionate to the benefits gained, and the expected impact on investment, innovation and growth in different types of enterprise, sectors and economies will be monitored carefully; not least by businesses, which would be well advised to keep a keen eye on the direction of travel and its potential to stifle innovation and digital confidence. This is particularly the case when considering investing in emerging technologies which enable more remote activity, such as Internet of Things, AI and distributed ledger, within their digital operating models.

We note that the Secretariat Proposal does not represent a consensus reached by the OECD member countries, indeed it seems to have been borne from a lack of consensus. It will be interesting to see whether countries coalesce round this proposal in the coming months. It seems clear that, if agreement can be reached, any reforms proposed will be radical and substantially change how and where global multinationals are taxed.

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FRANCE

The French Digital Services Tax

by Emmanuelle Pontnau-faure

The French DST, which is expected to affect about 30 multinational corporations, has been designed to target digital giants such as Google, Amazon, Facebook and Apple. The tax has been conceived as an interim measure and it is expected to be repealed once a global solution is found at the OECD level.

The French DST will have retroactive effect as from 1 January 2019 and it will apply to companies, irrespective of their country of establishment, with worldwide revenues from taxable digital services exceeding €750 million per annum and with more than €25 million annual revenues from taxable digital services supplied in France.

Taxable digital services

For the purposes of the French DST, the taxable digital services include:

- intermediation services, i.e. the supply, through electronic means, of a digital interface which enables users to interact with each other, notably for the purpose of exchanging goods or services; and
- targeted advertising services based on user's data. These services may include, but are not limited to, the purchase, storage and distribution of advertising messages, advertising control and performance measurement, as well as services for the management and transmission of user data, including the sale of users' data.

Exemptions

The provision of a digital interface will be exempt from the French DST, where such digital interface is used to:

- provide users with digital content, communication services and payment services;
- manage systems and regulated financial services such as interbank settlement or settlement systems and the delivery of financial instruments, trading services, advisory services on crowd investing and crowdfunding intermediation services, and other intermediation services which are subject to authorization; or
- enable the purchase or sale of advertising services.

In addition, the provision of digital services between entities of a consolidated group for financial accounting purposes will be exempt from the French DST.

Territorial scope

Digital services will be taxable for French DST purposes insofar as they are provided in France. The criteria for assessing the digital services' nexus to France vary depending on the nature of the services. Thus:

- with regard to intermediation services on a digital interface, the service will be deemed to be supplied in France if at least one of the users is located therein or if one of the users' interface accounts is opened from France;
- with regard to targeted advertising services, the service will be deemed to be supplied in France if the user consults the digital interface displaying the targeted advertising through a device located in France. The geolocation of such device may be determined on the basis of its Internet Protocol (IP) address or by any other means;
- with regard to the sale of users' data for advertising purposes, the sale will be deemed to take place in France if the data have been generated by a user located in France.

INSIGHTS

- **3% tax levied on digital intermediation services (e.g. online marketplaces) and targeted advertising services.**
- **The legislation is already enacted and applies with retroactive effect from 1 January 2019.**
- **Following discussions with US representatives, France has agreed to abolish this tax once international agreement is reached on this subject and will reimburse companies that pay French DST once the agreement is in place.**

Tax rate and tax base

The French DST, which will be deductible for French corporate income tax purposes, will apply at a single rate of 3% to total gross revenues, net of VAT, derived from the supply of taxable digital services in France during the year in which such tax is due.

The portion of the revenues attributable to France will be computed on the basis of the worldwide revenues from taxable digital services, to which a percentage of the share of the services attributed to France will be applied. The criteria for the determination of such percentage will be, depending on the nature of the service provided, either the location of the user in France in relation to the total number of users or the number of accounts opened from France in relation to the total number of accounts.

Tax collection mechanism

The triggering event of the French DST, which will also be its due date, will be the end of the calendar year, i.e. 31 December. A self-assessment regime will apply and the French DST will be declared, recovered and controlled according to the rules applicable to French VAT, subject to certain adjustments.

An annual tax return will have to be filed in April of the year following the one in which the French DST is due. Tax payment will be made in two instalments in the year in which such tax becomes due. Such instalments must be at least equal to half of the amount of tax that was due in respect of the previous calendar year. The payment of any balance will be made upon the filing of the annual tax return in April. Any overpayment will be offset against the subsequent tax instalments or, in case of absence or insufficiency of such instalments, it will be reimbursed. By way of derogation, the payment of the tax due for 2019 will be made in a single instalment in October 2019, which will correspond to the notional French DST based on 2018 figures.

Taxpayers not established in the EU or in any other European Economic Area member state, which has concluded with France an administrative assistance agreement against fraud and tax avoidance and a mutual assistance convention on the collection of taxes, will be required to appoint a tax representative subject to VAT in France to file the French DST return and pay the corresponding tax on their behalf.

A company member of a consolidated group for financial accounting purposes may make an election to file the French DST return and pay the tax on behalf of all group companies. Such election will take effect upon filing of the French DST return in the year following that in which the election is made and it will be valid for at least three years. For 2019, this election may be made until 31 October, 2019 and it will take effect as of the first tax payment made following that date.

The standard statute of limitations which applies to the French DST is 6 years. However, a 10-year statute of limitations applies in the event of fraud.

Compatibility with international tax law

The French DST raises questions about its compatibility with international tax law. There are serious doubts that France could tax profits that would not otherwise be taxable in France under tax treaty law. In addition, such tax may not be compatible with the EU principle of freedom of establishment and the EU State aid rules.

US response to the French DST

The US have opposed unilateral efforts to impose special taxes on digital activity, instead advocating a multilateral approach through the OECD to address the challenges to the international tax system posed by the digital economy.

The US have particularly opposed the French DST, viewing it as targeting US digital company giants, such as Google, Apple, Facebook and Amazon. Following adoption of the French DST, the Office of the United States Trade Representative (USTR) initiated an investigation under Section 301 of the Trade Act of 1974. The USTR indicated that the French DST unfairly targets certain US-based technology companies. For example, the revenue thresholds in the French DST have the effect of subjecting to the DST larger companies, which tend to be the US companies, while exempting smaller companies, particularly those that operate only in France. Moreover, the French DST does not apply to traditional advertising platforms such as radio, television, and print, among others, but rather is limited to digital advertising and the sale of personal data.

At the G7 Summit in August 2019, the US and France reportedly reached an agreement to settle their differences over the French DST. Under the deal, France will abolish its 3% DST once a new international taxation agreement is reached, which the OECD expects to occur by 2020. France will reimburse companies that pay the DST once the international agreement is in place.

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USA

US GILTI Rules and G7 Response

by Jeff Koppele and Sharon Kim

In tax reform legislation enacted in late 2017, the US significantly changed the taxation of US multinational companies' foreign profits. Among other changes, the legislation introduced the concept of "global intangible low tax income" or GILTI.

The primary purpose of GILTI is to reduce the incentive for US-based multinationals to shift profits out of the US into low- or zero-tax jurisdictions, using intellectual property and other forms of tax planning. GILTI attempts to achieve this by imposing a floor of between 10.5% and 13.125% on the average global tax rate of US multinationals. As a result, a US multinational looking to move royalties and other intangibles income out of the US would compare a 21% US domestic rate with a 10.5% – 13.125% rate rather than a zero rate. Very generally, GILTI is a tax on earnings that exceed a 10% return on a non-US subsidiary's invested foreign tangible assets. GILTI is thus a (very) rough proxy for royalties and other income earned on intangibles.

At the Chantilly, France meeting of the G7 finance ministers in July 2019, the ministers noted that Pillar Two of the OECD's proposals on how to tax the digital economy required a minimum level of effective taxation. Citing the US GILTI regime as an example, ministers said a similar global minimum tax could curb criticism that unilateral digital tax proposals discriminate against US companies.

INSIGHTS

- **The US GILTI rules have been in place since December 2017.**
- **The rules are a tax on earnings exceeding a 10% return on a non-US subsidiary's invested foreign tangible assets.**
- **As noted by the G7, GILTI is similar in concept to the global minimum tax proposed by the OECD.**

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USA

US proposed regulations on digital content transactions

by Jeff Koppele and Sharon Kim

The US Treasury recently issued proposed regulations on "digital content" transactions that may potentially subject to US tax certain non-US companies selling digital content to US customers. For purposes of the regulations, digital content includes content in digital format that is either protected by copyright law or is no longer protected by copyright law solely because of the passage of time. This would cover music, video, books, software and other computer programs in digital format. The proposed rules would not cover granting a right to publicly perform or display content for the purpose of advertising the digital content

INSIGHTS

- **Proposal to tax non-US companies making sales of "digital content" to US customers.**
- **Apparent contradiction of the international principle that taxing rights should not be based solely on location of sales.**
- **State sales taxes on remote sales are increasing; applicable laws in any potentially relevant state must be considered.**

Under existing US tax rules, gain, income and profits on digital content are sourced to the jurisdiction in which title to the content passes. The existing rules do not specify where title passes for copyrighted content, and generally permit parties to agree by contract where title passes. The US Treasury have expressed concern that a rule permitting parties to specify the location of a transfer as other than the customer's location is easily manipulated. The proposed regulations therefore treat the transfer of digital content through an electronic medium as occurring at the location of download or installation onto the end-user's device used to access the content. In the absence of information about the location of download or installation, the proposed regulations deem the sale to have occurred at the customer's location, based on the seller's recorded sales data for business or financial reporting purposes.

Under the proposed regulations, then, a non-US company's sales of digital content to US customers could potentially give rise to US source income. The sourcing of income is important for a number of US tax reasons. It can affect whether a non-US company is subject to US income or withholding tax, and whether a US companies may utilize its foreign tax credits, among other issues.

The proposed regulations will apply prospectively to tax years beginning on or after the date final regulations are published.

Takeaways: US Federal and State/Local Taxes

The proposed regulations on digital content may appear to contradict the broader international tax principle that a country does not have the right to tax based solely on sales to customers in the country.

Under existing US federal tax law, however, digital sales sourced in the US, without more, are not considered to result in a "US trade or business", a necessary prerequisite under internal US tax law for the US to impose federal net income tax on a non-US company. Further, companies eligible for benefits under a US tax treaty continue to enjoy the increased protections offered thereunder, which, consistent with current international treaty standards, require a permanent establishment of a physical nature as a condition to US federal net income tax liability. That said, as noted above international efforts to move to an economic nexus standard ultimately may result in the US modifying their tax treaties and internal federal tax law to address the economic nexus and other issues posed by the digital economy.

Non-US companies should be aware that US states, which are not bound by US tax treaties, have already taken significant strides in this direction. While US states historically were not permitted to tax a company selling to customers in the state unless the company had a physical presence there, many states now seek to collect sales tax from remote sellers. The US Supreme Court, in its June 2018 *Wayfair* decision, upheld South Dakota's sales tax law in this regard. Interestingly, the South Dakota law shares certain elements with the OECD consultative proposals described above, including a "substantial nexus" threshold of US $100,000 in annual sales or more than 200 separate transactions. As a result of the *Wayfair* case, physical presence is no longer the standard: US states can now tax remote online sellers. The states have responded quickly. In 2018 and 2019 most US states added economic nexus provisions to their sales tax laws. In addition, while the court in *Wayfair* specifically addressed a sales tax law, many believe that the implications of Wayfair also support an economic nexus approach for state income taxes as well.

Tax laws differ significantly among the 50 US states (and the numerous localities that separately impose sales taxes). Moreover, state and local tax rules and interpretations change frequently. Non-US companies selling into the US can no longer rely on the absence of physical presence as protection from US state sales and income taxes. Such companies would be well advised to consider the applicable rules in each state (and locality) in which they have customers and must stay on top of a slew of changing regulations and interpretations.

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UK

The UK's proposed Digital Services Tax

by Paul Miller, Nicholas Gardner and Vicky Brown

The UK government, in keeping with its reputation for swift implementation of global tax initiatives generally, has also announced a tax on certain digital services which is to apply from April 2020.

As with the other jurisdictions taking unilateral action, the UK's decision to introduce a digital services tax was initially prompted by frustration at the slow pace of progress by the OECD and EC in this area. As noted elsewhere in this publication, the OECD has criticised this as potentially "undermining the relevance and sustainability of the international framework for taxation of cross-border business activities". In addition, this "proliferation of uncoordinated" actions, which includes domestic measures proposed by Spain, France, Italy, Australia and Mexico, and legislation already enacted by India introducing a concept of "substantial economic presence" - all of which operate in different ways, on different bases and at different rates – creates enormous scope for confusion, double taxation and disproportionate administrative burdens.

Despite calls to wait for coordinated international action, a strong domestic political impetus for ensuring global tech giants operating in the UK are "paying their fair share" of tax means that the government has nonetheless forged ahead: draft legislation and guidance, explanatory notes, a policy paper and an outcome to a November 2018 consultation were published in summer 2019. Further updates are now awaited, although there have been calls for the introduction of this tax to be delayed in view of recent progress by the OECD.

Perhaps unsurprisingly, given the UK's proposed DST's similarity to the French DST, US representatives have also been putting pressure on the UK to drop its plans in this area. Prior to the G7 Summit, the Prime Minister Boris Johnson reportedly expressed a willingness to consider redrafting these DST rules as part of a broader post-Brexit US-UK free trade deal with the US, but apparently no such deal has yet been reached.

Key features

The key features of this new tax are as follows::

- the DST will be a 2% tax on the UK gross revenues of certain digital businesses. Importantly this is thus a tax on revenues rather than on profits;
- the business activities in scope are **social media platforms**, search engines and online market places (other than market places provided by financial services providers in connection with the trading or creation of financial assets), together with any associated online advertising business deriving significant benefit from its connection with the in-scope activity;
- the tax will apply only to revenues linked to the participation of a UK user base;
- a business will only become taxable if the global group of which it is a part generates:
  - more than £500m in global annual revenues from in-scope business activities; and
  - more than £25m in annual revenues from in-scope business activities linked to the participation of UK users;
- businesses will not have to pay tax on their first £25m of UK taxable revenues;
- in order to avoid prejudicing low profit margin businesses, an election for an alternative tax base will be available;
- DST payable may potentially be deducted from profits subject to corporation tax but DST will not be creditable against the corporation tax actually due (nor, as a tax on revenues, will it be creditable under the UK's double tax treaties);
- companies will be required to self-assess liability to the DST and pay any DST due annually. Other companies within the group may be made jointly and severally liable for the tax;
- the tax will be reviewed in 2025, alongside a consideration of progress in international discussions, to determine whether it remains necessary. However, the consultation response notes that "an international solution would need to address the specific policy concern that has been identified by the UK, and lead to a greater allocation of profit of highly digitalised businesses to the countries in which their users are located"; the implication here being that, if the OECD solution doesn't reflect this approach, the DST will be retained indefinitely and alongside the global tax changes in this area.

INSIGHTS

- **2% tax levied on social media platforms, search engines and online market places.**
- **Draft legislation is heavily reliant broad definitions, and on the identification of the location of users and attribution of revenues being carried out on a "just and reasonable" basis. Clear and detailed guidance will be crucial.**
- **Indications that a redraft of these rules might be on the negotiating table as part of wider free-trade discussions with the US.**

Remaining issues

Despite changes following on from the consultation, which are intended to focus the proposal more closely on the policy objectives and improve the administration of it, a number of issues, both conceptual and mechanical, remain.

Definitions of in-scope businesses and revenues

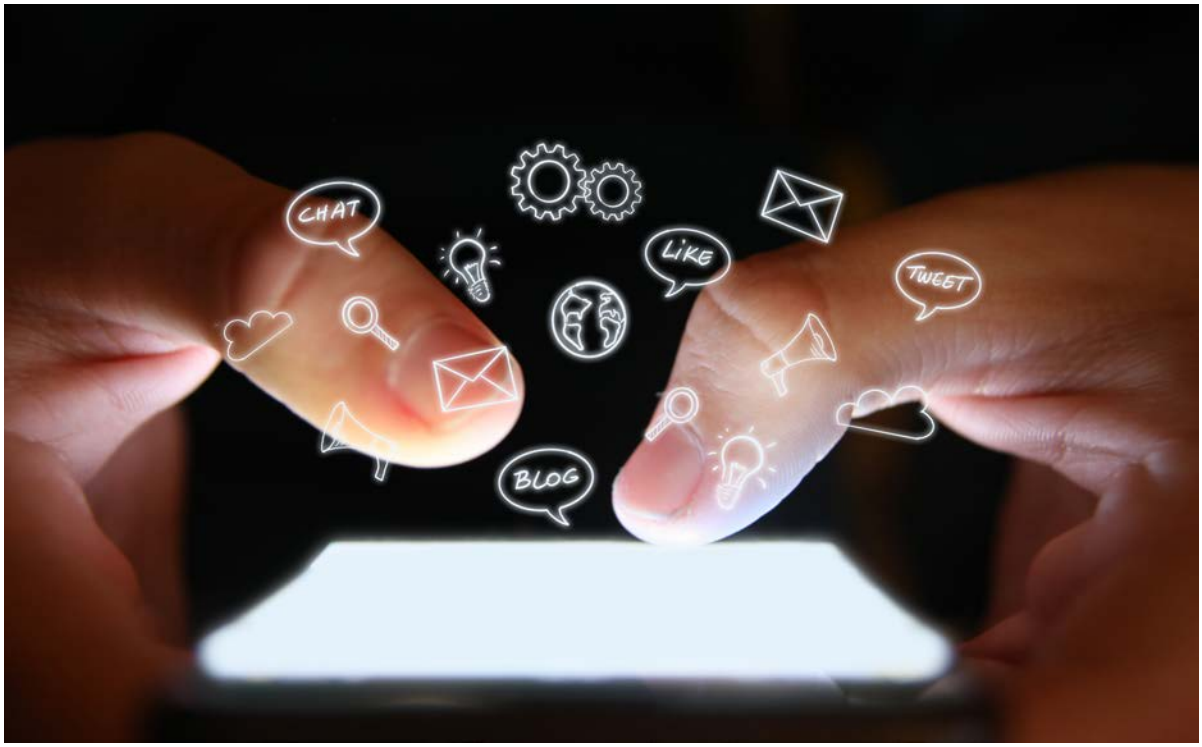
The UK's approach is to define objectively a limited number of business activities that derive most value from user participation and to tax all UK revenue streams from these activities; it is therefore not relevant how the business monetises its digital engagement. This approach has echoes of the OECD's proposals to re-allocate taxing rights to the so-called "market jurisdiction" (i.e. that in which the user or consumer is located) but the OECD's proposals go much wider so that the new taxing right would attach to large "consumer-facing" businesses generally where these have a "sustained and significant involvement in the economy of a jurisdiction".

The UK, by contrast, has jumped straight to three specific targets, being the type of digital businesses it considers to be most obviously benefiting from user participation.

While this might be seen as a more simplistic approach to defining the scope of the rules (albeit one which is likely to be anything but simple to operate in practice), it is fair to note that the DST is intended to be in place only until international measures are agreed and implemented and the UK has committed to engaging with the OECD process.

The three targets of the DST, (i) social media platforms, (ii) search engines and (iii) online market places, have been defined in the draft legislation or otherwise delineated in the draft guidance, broadly as follows:

- "**social media platforms**" are those which enable content to be shared and where there is a main purpose of promoting interaction with other users and the content provided by those users. This would be shown by factors such as growth and engagement of the user base being a key performance indicator which might be expected to be monitored by external investors and whether the ability to interact with other users is an important driver in attracting further users to the platform. The government anticipates that this would include social networks, microblogging sites, video or image sharing platforms, review platforms and online dating sites. The scope of this "social media platform" head is perhaps the one that is least immediately obvious and may surprise some;



- "**internet search engines**" are not defined as it is expected to be clear under the normal understanding of the term when a business is providing this activity. Essentially, it will extend to engines that allow a user to view webpages beyond those provided by the platform itself and would therefore not include search functions to find pages or content within a site;
- "**online market places**" are platforms with a main purpose of facilitating the sale or hire of (by allowing users to advertise, list or sell) goods and services to other users, whether or not the transaction concludes on the market place or away from it.

Notably, and following responses to the November consultation, online financial market places have been specifically excluded from this definition, largely on the basis that the financial services industry is highly regulated and therefore are required to bear specific financial risks rather than relying on users to bear those risks. This regulated nature also means that their activity is likely to be localised, meaning that the underlying rationale about profit attribution may be less relevant. Online financial market places are those provided by a financial services provider and where more than half of the relevant revenues arise in connection with the provider's facilitation of the trading or creation of financial assets, including insurance contracts.

The draft guidance indicates activities that are specifically not intended to be caught by the DST, such as the provision of online content and the sale of own goods online, and provides some guidance on borderline scenarios. However, given the scale and continued rise of innovative digital products available now and the fact that they evolve rapidly, determining where any given activity sits will not always be easy. Already it is acknowledged that online games share similar features to social media and online market place models and will need further consideration. No doubt there are many more such examples.

The revenues subject to DST include all third-party revenues generated from in-scope businesses where linked to the participation of UK users. The identity and tax residence of the recipient of the revenues within the worldwide group is not relevant. The revenues are obviously not limited to payments by the particular UK user; on the contrary they are expansively defined and would include all payments for online advertising, subscription fees, sales of data, click-through commissions etc. About the only useful exception is that intra-group payments are not caught, although this is because third party revenue (wherever earned in the group structure) which relates to the participation of UK users will be in-scope.

Multinational enterprises with a mixture of in scope and out of scope activities will need to attribute revenues on a "just and reasonable basis". This may or may not be a straightforward task, depending on the degree of separation of the business activities, but is likely to be a concern regardless and the method used may need to be the subject of a pre-clearance from HMRC.

UK user participation

The policy behind the DST is to ensure that multinationals with a significant presence in the UK pay an acceptable level of tax here on the basis that value is generated by UK

users of the platform. Unhelpfully, a "UK user" is defined in the draft legislation simply as a person who it is reasonable to assume is normally in or established in the UK. Draft guidance indicates that this may be based on any available evidence, such as payment details, delivery addresses, IP addresses or the intended destination of advertising based on contractual evidence.

Following the determination of where the user is located (which may not be straightforward), there is then the question of where and how value is generated by user activity, and on what basis it should be calculated. It is notable that the OECD is now side-stepping this question to some degree by using simplifying conventions such as agreed fixed percentage returns on certain activities.

Even assuming it can be shown that value is generated, it will not always be easy to determine to which market jurisdiction it should be linked. The UK draft rules provide simply that, save in specified circumstances, where revenues arise in connection with UK users and others, the revenues are to be treated as attributable to UK users to such extent as is "just and reasonable". The specified circumstances are online marketplace revenues arising in connection with interests in land or provision of accommodation in the UK, which will be treated as attributable to UK users regardless of the location of the parties to the transaction, and online advertising revenues will fall within the DST where the advertising is intended to be viewed by UK users.

The draft guidance amplifies the "just and reasonable" apportionment requirement to some degree. Subscription fees, payments to access content or a premium service will all be UK relevant revenues where paid by a UK user. Where the revenue or user activity is not so easily tracked, businesses are given little assistance but can perhaps extrapolate from the guidance given in respect of apportioning advertising revenues. This lists a number of potentially relevant factors such as the relative volume of users, the relative engagement of users and the size and maturity of the platform in each jurisdiction.

Helpfully, the UK's proposal to treat all of the commission earned on a transaction as UK revenue provided either one (or both) of buyer and seller is UK based has been amended. Recognising the potential for double taxation here, the taxable amount is halved where the other user is normally located in a country with a similar tax to DST.

Alternative calculation election

The DST, in common with certain other unilateral proposals, is based on gross revenues and would therefore result in punitive effective tax rates for those with low profit margins. This "safe harbour" election moves the calculation of the DST from a turnover-based test to one which takes into account the profit margin of the company or group in question. The proposed calculation, as confirmed in the draft legislation, is:

Profit margin * in-scope gross revenues over £25m * 0.8

This would have the effect of capping the rate of DST at 80% of the business's profits over the £25m allowance. While this would be of benefit to any business with a profit margin of less than 2.5% (including, of course, loss making companies), it is still potentially an extremely high rate of tax and demonstrates how disproportionate the effects of a tax on gross revenues rather than profits can be. Moreover, there is a whole raft of issues around how to define and calculate the "profit margin" for these purposes and the timing and revocability of such elections.

In particular, although most normal operating costs will be allowable in calculating the margin (provided these have been determined in accordance with GAAP), certain costs will not be allowable; notably interest expenses, expenditure on acquisitions and any exceptional costs.

Deductibility of DST

The DST will be calculated and reported at the group (rather than entity) level, including any thresholds. However, the DST liability and expense will sit with the entities generating the underlying revenues on which that DST is payable.

Businesses subject to UK corporation tax will be able to deduct the DST expense for UK tax purposes if and only if it is deductible as a business expense under the normal UK corporation tax rules. This means that, in order to be deductible as a cost against profits for CT purposes, it needs to have been incurred wholly and exclusively for the purposes of the trade in the entity which incurs the DST, i.e. that which receives the taxable revenues. It is expected that this will normally be the case as the DST expense is directly related to the earning of its revenues and is a legal obligation of performing that trade.

However, that is not any help to non-UK tax resident businesses. Again, this is recognised in the consultation document, but the only solution would appear to be restructuring group arrangements and intra-group payments where possible to mitigate against the tax charge being in a non-UK taxpaying company.

The consultation document was clear that the tax is not intended to be creditable under double tax treaties, again raising the spectre of double taxation, and this position has not changed.

Further Thoughts

In addition to the other points here, there are some less obvious but potentially important points that we think are worth flagging:

1. **The group aspects**. The UK has not historically had many taxes payable on a group basis. The main exceptions being VAT groups and the way in which the corporate interest restriction was adopted. Based on the issues we see in those contexts, we can believe that this aspect may have some major impacts for joint ventures and lenders into sub-groups. The impact on securitisations will also need to be considered.
2. "**Revenue**". This follows an accounting definition. If a particular transaction could either be accounted for as either: (i) gross revenue of 2 and nil expense; or (ii) gross revenue of 100 and gross expense of 98; the tax burden is drastically reduced if the first method is appropriate.

Way Forward

The intended targets of the DST are clear; it is easy to think of a number of household names which fall into the categories of social media platform, search engine or online market place, and given the size of the thresholds, there will be few others caught. However, the scope of the DST is widely drawn in places and, given the continued uptick in strategic acquisitions, market consolidation and collaboration in the UK digital economy, as means to maintain competitive innovation, many more businesses may be drawn into the scope of the regime. Businesses that do find themselves on the wrong side of the line face what could be complicated attributions of revenues and, for those with low profit margins, potentially eye-watering effective tax rates above the £25m threshold.

The UK government has reached for its usual solution to broadly-drafted legislation i.e. issuing guidance to "clarify" the precise application of the rules. However, rapid change and innovation is in the very nature of the digital economy and such generalised guidance as is found in the current draft will not be of much assistance at the (crucial) margins. Of more use is the government's commitment to provide a non-statutory clearance mechanism for taxpayers; a sensible and prompt approach to queries will be invaluable.

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SPAIN

The Spanish Digital Tax

by Eduardo Gracia, Lorena Viñas, Javier Hernández Galante and Ricardo García-Borregón

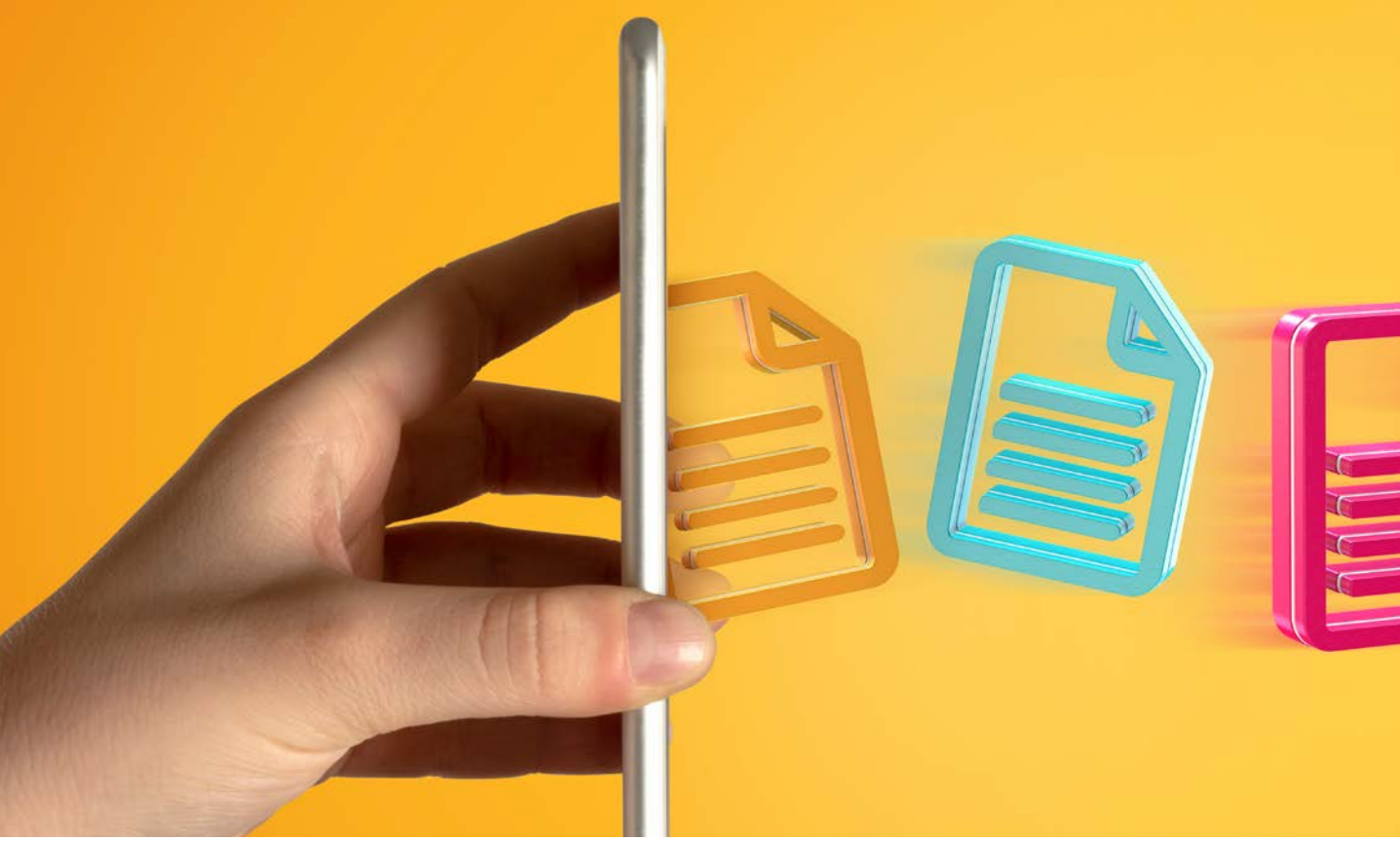
The process for reviewing the current tax rules as they apply to the digital economy has been taking place at international level, both within the OECD and the EU, for years. However, since the adoption and implementation of these measures agreed at international and multilateral level could take a long time, Spain has begun to adopt, on an interim basis, unilateral measures to try to address this problem.

On 18 January 2019, the Spanish government approved a Bill which will provide for a tax on certain digital services (the "Spanish Digital Tax") but this has not yet been enacted, due to the dissolution of the Spanish Parliament pending formation of a new government. It is therefore as yet unknown whether the future new government will continue with this proposal or similar.

The scope of this new tax is largely in line with the one proposed by the European Commission in its proposal for a Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services (the "Proposed Directive"), and it is intended to be conformed with the European proposal if and when this is finalised. At present, however, the EU proposal for a tax on digital services has been paralysed due to the refusal of some Member States to move forward with it.

INSIGHTS

- **Scope of the new tax broadly follows the EC's proposed Directive on taxation of digital services, albeit that the EC proposals are currently stalled.**
- **3% tax levied on online advertising services, intermediation services and data transmission services.**
- **Digital Services Bill is held up until a new Spanish government is formed and therefore the introduction of this tax is currently uncertain.**



The main features of the Spanish Digital Tax (as currently provided in the Bill) are as follows:

Taxable event

The provision of certain digital services carried out in Spain (which, for these purposes includes all Spanish territories) by "taxable persons" will be subject to the Spanish Digital Tax.

The digital services subject to this tax are those in relation to which there is a user participation that contributes to the value creation process of the company that provides the services, and through which the company monetises those user contributions. In other words, the services included in the scope of this tax are those which would not be able to exist in their current form without users involvement.

These digital services are defined in the same way as in the Proposed Directive. Thus, the revenues included in the scope of this tax are solely those derived from the provision of any of the following services:

- services consisting in the placing on a digital interface of advertising targeted at users of that interface ("online advertising services");
- services consisting in the making available of multi-sided digital interfaces to users, which allow users to find other users and to interact with them, and which may also facilitate the provision of underlying supplies of goods or services directly between users ("online intermediation services"); and
- the transmission of data collected about users which has been generated from such user's activities on digital interfaces ("data transmission services").

Spanish users

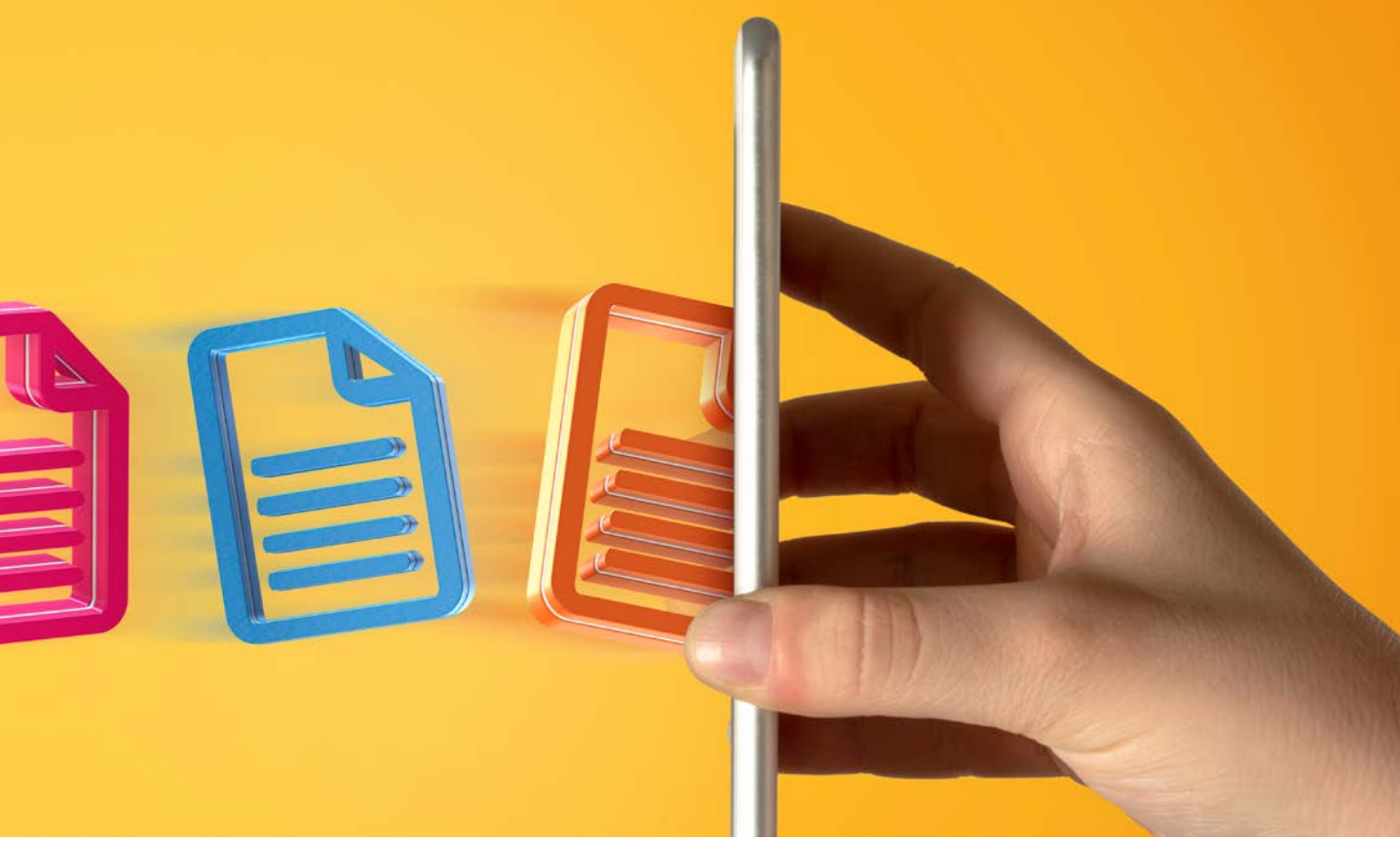
Only the provision of digital services used by persons located in Spain will be subject to the Spanish Digital Tax. Specific rules determine when users will be considered to be located in Spain, depending on the digital service in question, and these are based on the place where the devices of those users have been used. The place of location of these devices will generally be determined by reference to their Internet Protocol (IP) addresses, unless other evidence is used, e.g. other tools for geolocation of the devices.

These new links for determining the place of consumption of the digital services provided will be challenging both for the Tax Authorities and the taxpayers, with the latter already expressing confusion over how they will determine the location of the users of their services and concern regarding technological and technical limitations for locating the IP addresses of their users.

Taxable persons

Legal entities which, irrespective of their tax residency, comply with the following two requirements at the beginning of the settlement period, will qualify as taxable persons for the purposes of the Spanish Digital Tax:

- the net amount of its turnover in the previous calendar year exceeds 750 million euros (as established in the Proposed Directive); and
- the total amount of their taxable revenues corresponding to users located in Spanish territory and corresponding to the previous calendar year, exceeds 3 million euros.



The first threshold limits the application of the tax to large companies, which are those capable of providing these digital services based on data and user contribution, and which rely heavily on the existence of extensive networks of users, on big data traffic and on the exploitation of a strong market position.

The second threshold limits the application of the tax to cases where there is a significant digital footprint in the territorial scope of application of the tax in relation to the revenues covered by the Spanish Digital tax.

Special rules are established for entities belonging to a group; in order to determine whether an entity exceeds the thresholds and is therefore considered a taxable person, the thresholds must be applied in relation to the amounts applicable to the whole group.

Tax base, rate and settlement period

The tax base of the Spanish Digital Tax will be the amount of the VAT-exclusive revenues earned by the taxable person for the provision of any of the in scope digital services. For the purpose of calculating the tax base, only the proportion of revenues corresponding to users located in Spain in relation to the total number of users will be taxed.

The Spanish Digital Tax will be levied at a single rate of 3% (as set out in the Proposed Directive), the accrual will be produced for each service provision taxed, and the settlement period will be quarterly.

Final remarks

With the progress of the Spanish Digital Services Bill held up while a new government is formed, it is uncertain whether this new tax will be introduced and, if so, in what form.

Assuming any such tax will remain similar to that in the Proposed Directive, there will be doubts as to its technical application as it will introduce new criteria for taxing the new digital economy, particularly in determining the place of consumption, which opens the door for a future paradigm shift on how these new ways of doing businesses will need to be taxed.

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AUSTRALIA

Australia and the digital economy

by Laura Scro, Elke Bremner, Barbara Phair and Bill Cannon

Consistent with other jurisdictions taking action, Australia has chosen to take a unilateral approach in respect of GST and the digital economy. As of 1 July 2017, Australia's GST law has been broadened to capture supplies of intangible items from foreign suppliers to Australian "non-business" consumers. These provisions are wide-reaching, and impact foreign suppliers of online digital content (e.g. movies, television shows, apps and music) and advisory and professional services (e.g. brokering, legal and financial advisory services) who make supplies to Australian based consumers and who otherwise have no business connection with Australia.

The GST law was also amended with effect from 1 July 2017 to impose GST on supplies of low value goods (i.e. goods with a value of less than A$1,000) from foreign suppliers to Australian consumers. Under these amendments, foreign suppliers (or deemed suppliers) of low value goods to Australian consumers may be required to register for, collect and remit GST on supplies of low value goods to Australian consumers.

Australia was one of the first jurisdictions to implement GST regimes which target foreign supplies of online digital content and supplies of low value goods from foreign suppliers to Australian consumers. Similar to other jurisdictions, a key driver of the introduction of these regimes was the perceived need to protect tax revenue and Australian domestic businesses from unfair competition.

The introduction of these amendments has raised a number of practical complexities and issues, in particular, the need for foreign suppliers or deemed suppliers who meet the annual registration turnover threshold of A$75,000 or more to now register for Australian GST with the Australian Taxation Office (ATO).

Impact on foreign suppliers

Foreign suppliers of intangible items and low value goods to Australian consumers will need to determine whether they will be subject to the new provisions and, if so, take steps to register for Australian GST.

Foreign suppliers will also need to review and monitor their business systems and processes to ensure that they are capable of complying with the new information requirements.

Background

The reach of Australian GST on inbound supplies has expanded considerably under the new measures introduced on 1 July 2017. There are two relevant aspects to the changes:

- foreign suppliers making supplies of intangible items (basically, anything other than real property or goods) to Australian "non-business" consumers may be required to register for, collect and remit Australian GST of 10% in respect of those supplies;
- the supply of low value goods (i.e. where the value of the goods is less than A$1,000) from a foreign supplier (or deemed supplier) to Australian consumers will also attract GST payable by the supplier.

Inbound supplies of intangibles

In the past inbound supplies of things other than real property or goods generally only attracted Australian GST where the supplier made the supply through a business they carried on in Australia. This means, for example, a customer in Australia could have downloaded digital products from a supplier outside Australia without the supplier needing to register and remit any Australian GST.

Under the new provisions, GST now applies if all of the following requirements are met, even where the supplier has no presence in Australia:

- the customer is an Australian resident; and
- either:
  - the customer is not registered for Australian GST; or
  - if registered, the customer does not acquire the thing supplied for the purpose of a business they carry on (Australian consumers); and
- the supplier makes or expects to make supplies to Australian consumers with a value of approximately A$75,000 or more in any rolling 12 month period (which means that the supplier is required to register for Australian GST).

Responsibility for the GST liability may be shifted to the operator of an electronic distribution platform (EDP) if the supply is made though an EDP and the operator controls any of the key elements of the supply, such as price, terms and conditions or delivery arrangements. Operators and suppliers may also agree in writing that the operator will assume liability.

INSIGHTS

- **Extension of GST to capture foreign suppliers of online digital content and advisory and professional services to Australian consumers where those suppliers have no other business connection with Australia, and supplies of low value goods from foreign suppliers to Australian consumers.**
- **New rules in place since July 2017 and considered to be successful in protecting tax revenues and Australian businesses from unfair competition.**
- **Australian government has announced that it will pursue a long-term international consensus solution in the direct tax sphere and will not implement interim unilateral measures.**

The complexities for foreign suppliers in applying these rules are obvious. Here are a few common questions and some guidance:

How do suppliers identify whether the customer is an Australian resident?

The supplier can treat a supply as not made to an Australian consumer if the supplier has obtained particular evidentiary requirements, and reasonably believes that the customer is not an Australian consumer. The ATO has sought to provide guidance on what steps a foreign supplier should take to establish whether a customer is an Australian resident in a public ruling (Goods and services tax: making cross-border supplies to Australia consumers GSTR 2017/1). In particular, the ATO accepts that a supplier can satisfy the residency test relying on information gathered through existing business systems (such as address or credit card details) where these provide a reasonable basis for believing the customer is not a resident of Australia.

How do suppliers know if their customer is registered for Australian GST?

The ATO's view is that a supplier can only rely on this exception where the customer has disclosed an Australian Business Number (ABN) and provided a declaration or other information that indicates that they are registered for GST. An ABN alone is not sufficient as a customer can have an ABN and not be registered for GST.

Suppliers can check a customer's ABN and whether they are registered for Australian GST on the Australian Business public register on the ATO website. However, the ATO view suggests that a supplier cannot rely on this information alone.

If the customer is registered for Australian GST, how do suppliers know if they will use the thing supplied in connection with their business?

GSTR 2017/1 does not provide guidance in relation to this test, other than to note that it would be unusual for a GST registered entity to make an acquisition for a purpose other than the enterprise carried on by it. Where the items supplied could be used for private or domestic purposes, a foreign supplier could consider seeking this information as part of the declaration referred to above.

If a foreign supplier becomes liable to register and pay GST, what is involved?

Foreign suppliers can either register for GST under the normal rules (requiring monthly, quarterly or annual lodgements) or can elect to adopt a simplified reporting method with a limited registration.

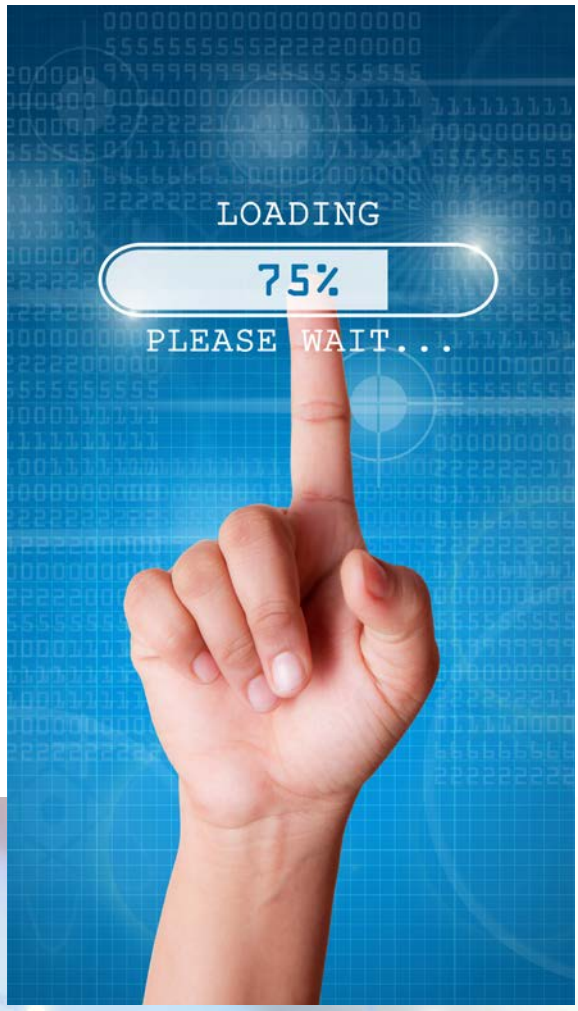
Under a limited registration (which can be revoked by the supplier at any time), foreign suppliers are not entitled to claim back Australian GST on their acquisitions by way of input tax credits, are not entitled to an ABN, do not have their details recorded on the Australian Business public ABN register and must lodge quarterly returns. No tax invoices or adjustment notes are required to be issued by foreign suppliers with only limited registration.

Can suppliers recover their GST liability on top of the price they charge to the customer?

No, unless the GST has been included in the price charged, or there is a contractual right to recover GST from the customer under the relevant terms and conditions, the supplier will need to absorb this cost. Australian consumer law also requires that suppliers display a GST-inclusive price. Suppliers who may be affected by these rules should check their standard terms and conditions and revise price lists as appropriate.

What supplies do these provisions apply to?

The provisions apply to all supplies made on or after 1 July 2017 (including the component of a periodic supply that occurs on or after 1 July 2017), regardless of whether the supplier can recover the GST from Australian customers.



Inbound supply of goods

With the removal of the low threshold value of A$1,000, in Australia, GST also now applies to the importation of goods which are brought into Australia with the assistance of a supplier (or deemed supplier), effective 1 July 2018. Australia is one of the first jurisdictions to legislate to make platforms liable for the collection of GST in respect of goods, as recognised in a key publication released by the OECD, "The Role of Digital Platforms in the Collection of VAT/GST on Online Sales", presented at the Global Forum on VAT in March 2019.

Where these provisions apply, it is the supplier (or deemed supplier) who is liable to register and remit GST to the ATO. Operators of EDPs and re-deliverers will be deemed suppliers. To address the potential for double taxation, where the supplier (or deemed supplier) reasonably believes that GST will apply to the supply under the existing taxable importation rules, no GST will be payable by them.

In most cases the A$1,000 threshold is determined based on customs value, and on the basis of the value of each individual item in a single consignment. For example, if a consignment includes six items with a customs value of A$200 each, the low value threshold will apply even though the total customs value of the consignment exceeds A$1,000. Where any individual item in a consignment has a customs value in excess of A$1,000, it will be treated as a separate supply of that item and the new rules will not apply (so that GST will be payable at the border on importation by the party entering the item for home consumption).

Affected suppliers will need to be able to distinguish these 2 categories of supplies.

As for the inbound supply of intangibles:

- the liability only arises where the supply is to an Australian consumer;
- suppliers can reasonably rely upon information provided by the customer to form a reasonable belief that the customer is not an Australian consumer; and
- the supplier (or deemed supplier) will only need to register and remit GST if they make or anticipate making supplies to which the new rules apply with a value of A$75,000 or more on an annualised basis.

While the supplier (or deemed supplier) is also relieved from the obligation to issue tax invoices, they must notify the customer in the approved form of the amount of Australian GST (if any) that is payable in relation to the supply.

"Reverse charge" on offshore supplies

Generally, GST will be "reverse charged" to the recipient of a taxable supply which takes place outside Australia if certain conditions are satisfied, including:

- if the supplier is a non-resident; and
- the supplier does not make the supply through an enterprise that the supplier carries on in Australia; and
- the recipient is registered or required to be registered; and
- the supplier and the recipient agree that the GST on the supply be payable by the recipient.

Where GST is "reverse charged" the recipient of the supply, rather than the supplier, is liable to the GST payable.

From 1 July 2018, the reverse charge provisions also apply to low value goods. The reverse charge rules will apply to low value goods if the following conditions are satisfied:

- the supply is for consideration; and
- the supply is a supply of low value goods; and
- the supply is not connected with Australia; and
- the recipient of the supply satisfies the purpose test i.e. the recipient of the supply acquires the low value goods supplied solely or partly for the purpose of an enterprise that the recipient carries on in Australia and the recipient does not acquire the thing supplied solely for a creditable purpose; and
- the importation of the low value goods is not a taxable importation in respect of which the recipient is liable to pay GST; and
- the recipient is registered or required to be registered for GST.

The way forward for Australia

GST and the digital economy

While the introduction of these amendments has raised numerous practical complexities, overall the implementation of these measures has been declared by the Australian Government to be a success in Australia.

The ATO announced on 4 July 2019 that revenue collected from the GST on low value goods measure has exceeded expectations with the ATO collecting over AUD$81m of GST within the first quarter, outstripping forecasts by AUD$70m. Within the first nine months of introduction, as at 1 May 2019, the ATO has collected AUD$250m in GST, outstripping forecasts by AUD$180m in total.

The ATO has also reported that since the introduction of the GST on low value goods measure, over 1,000 overseas businesses have registered for GST, which the ATO has stated includes all the known major suppliers and international platforms. While it has been argued that the introduction of this measure may be burdensome for small overseas businesses who may be required to register for GST in Australia, the ATO has maintained that small independent operators have not been largely affected. This is because businesses are only required to register for GST in Australia if they meet the relevant GST turnover threshold.

The ATO has claimed that the Australian approach is increasingly recognised internationally by bodies such as the OECD and the World Customs Organization as the model to follow. In light of the success of the introduction of these measures, in particular the success of GST on low value goods in Australia, the Australian Government has not announced any intention to amend the existing regimes.

Taxation and the digital economy

While Australia has taken a unilateral approach in respect of GST and the digital economy, it would be interesting to see the Australian Government's response if the OECD were to introduce reforms to taxation of digital services, and to what extent Australia would participate in such an initiative.

On 20 March 2019, the Australian Government announced that following a consultation process, it had decided not to implement any interim measures, such as a digital services tax, and would continue to focus on pursuing a long-term consensus solution at the OECD by continuing to engage with the OECD's multilateral process.

The Australian Government noted that this decision was influenced by various key stakeholders who raised significant concerns about the potential impact of the introduction of an Australian interim measure across a wide range of Australian businesses and consumers, including:

- discouraging innovation and competition;
- adversely affecting start-ups and low margin businesses; and
- the potential for double taxation.

To date, it appears that France's decision to implement a digital services tax has not impacted this position.

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