# Challenges to taxing the new global digital economy

E-commerce has blossomed into a new digital economy, but still provokes difficult questions in regards to the most efficient ways to impose taxes. Given that national treasuries seem to profit very little from the digital economy, efficient taxation has become a global issue that has prompted Organisation for Economic Co-operation and Development ('OECD') investigation. Numerous governments have also proposed solutions to the question. Michaela Merz and Daniel Barcellos of PricewaterhouseCoopers AG discuss the challenges and proposed solutions to taxing the internet.

E-commerce - the trade of goods and services conducted over a computer - was first established around 20 years ago and now accounts for a large part of global trade. To illustrate its current importance: global e-commerce sales to end consumers ('B2C') passed the $1.2 trillion mark[1] in 2013. They are now expected to have reached the $1.5 trillion milestone, and continue to grow year after year at the surprising rate of 20%[2]. In the meantime, a number of multinational digital traders generate annual revenues of tens of billions of US dollars, and treasuries are keen to get their share of this cake. Lately, we have observed numerous discussions on the most efficient ways to tax this new economy, as it is argued that national treasuries worldwide have been profiting very little financially from the digital economy.

In order to address the taxation challenges of the current age, the OECD published its Action Plan on Base Erosion and Profit Shifting ('BEPS')[3] in 2013, including information on the need to tackle the tax challenges of the digital economy. Remarkably, the main difficulties of taxing the digital market are (i) the correct market value of digital assets, (ii) the absence of a need for being physically present in a particular country in order to provide services, and (iii) the incorporeal nature of the supplies and services provided. Moreover, companies in the digital economy mainly have intangible assets (e.g. IP) in their books. This makes them very flexible market players that are not necessarily bound to a physical location, and they can most likely circumvent higher taxation at corporate level by relocating to more tax-friendly jurisdictions where the use of other legal instruments such as double taxation agreements and taxation gaps are available[4]. Whereas a country's unilateral attempts to tax income at corporate level will most likely produce limited financial results for the treasuries, taxing consumption proves to be more effective from a purely fiscal perspective. This shift to a consumption tax model for taxing this new economy was also recommended by the OECD more than one decade ago[5].

In most jurisdictions, some kind of VAT/GST is already applicable for locally purchased digital services. Cross-border digital services are, however, more difficult to tax because the providers of digital content have no or very limited physical presence in the countries where the services are consumed, their services being provided remotely through the internet. While tax authorities have more means to impose consumption tax on supplies provided by companies established within their sovereign territories, the same cannot be said for companies established in other jurisdictions. Tax authorities struggle to impose tax on non-established companies, firstly because of the lack of legal instruments and secondly because of the burden and complexity of tracking the supplies of digital suppliers to end consumers ('B2C supplies'). This means that non-established digital content providers would actually have an incentive not to comply with the local VAT/GST obligations (i.e. fail to remit the VAT/GST due in the consumer's jurisdiction), as there is no real possibility of tax authorities auditing and sanctioning them[6]. Obviously, an honest digital provider would still wish to fulfil its foreign tax liabilities and be compliant with the tax legislation in the jurisdictions where it operates. On the other hand, the immaterial nature of digital services seems to give local digital suppliers a competitive disadvantage compared to non-resident companies of this new economy.

Nevertheless, we have seen in the EU, Switzerland, Kenya, Iceland and most recently in South Africa that measures to close the tax gap for cross-border digital supplies are being put in place by harmonising both resident and non-resident digital service providers to the same indirect taxation rules. Some other countries, e.g. Canada, are in the process of reviewing their taxation scheme and have opened public consultations aimed at ensuring the effective collection of sales taxes on digital sales by non-established digital providers to residents[7].

Welcomed by the OECD and considered an example to follow, the EU has also introduced significant changes to its rules regarding the place of taxation for supply related to B2C supplies for telecom, broadcasting and digital services. As of 1 January 2015, VAT will be due in the Member State of residence of the end consumer, regardless of where the service provider is based or domiciled. In a nutshell, pursuant to the 'EU VAT package,'[8] the place of B2C supplies for such services will shift from the place of establishment of the EU supplier to the place of residence of the end consumers. These new rules eliminate the competitive advantage that EU-established digital service providers have vis-à-vis the non-established ones within the EU; the latter have long before 2015 been obliged to determine and remit the VAT due in the EU Member State in which digital content is consumed[9]. Companies providing digital services within the EU are not only faced with new taxation rules. Less capitalised companies such as medium and small-sized enterprises are overwhelmed with the new system and administrative burdens of the new place-of-supply rules in the EU, in particular with the legally required minimum evidence for determining the location of the B2C consumption[10]. If companies fail to provide the two pieces of evidence, they risk facing double taxation in different jurisdictions. Not to mention that in other countries, like Switzerland, even more rigorous requirements for determining B2C consumer location apply than in the EU.

In the last decade, we have also seen more and more aggressive attempts to tax the internet or the trade generated with it - and some of these have been very creative. To illustrate, we cite the 'Amazon law' (NY State, US, 2008), also known as the 'click-thru nexus,' which states that an online seller with no physical presence (out-of-state seller) is to be presumed to have nexus i.e. sales tax liability with the state if it pays a commission to a person who, through an internet link or otherwise, refers customers to the out-of-state seller's website. On a US nationwide level, we also highlight endeavours such as the Marketplace Fairness Act (US, 2013). Even though this act was not put into effect, it gives a clear signal to all players of the new economy that soon, internet trade will not be a tax-free ride in the US, and that similar efforts are highly likely to be undertaken in the near future.

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There is a clear trend of attempts to gain higher tax revenue from the internet. In Spain, a law nicknamed the 'Google Tax' was enforced in October 2014. Under this new law, any site that links to articles published by members of Spain's newspaper association is subject to a tax fee[11]. This became a particular burden to news aggregator Google News. The most recent and somewhat extreme example is the Hungarian 'internet tax,' which proposed a tax based on data volume only. This proposal resulted in immediate uproar amongst industry players and the general public, and was also spotted by the major international press. The immensely negative reception of the Hungarian 'internet tax' forced the Hungarian government to withdraw the proposal again[12].

The internet has long been considered no man's land, and some of its participants have been behaving accordingly. After several less successful attempts to tax internet providers at corporate level, we are now witnessing a general shift in paradigm from taxation of internet service providers to taxation at consumption level. We have also perceived that jurisdictions have made real progress in closing the taxation gap, and even cross-border B2C internet services - considered 'untaxable' by many for a long time - have, at a certain point, been successfully targeted. These supplies are or will be increasingly subject to some form of consumption tax such as VAT/GST. With the support of the OECD, more proposals to tax the internet are expected in the next few years, albeit mostly at consumption level.

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