Taxation of the digital economy (China’s Digital Transformation)

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27 August 2014
Agenda

1. The world changing around us
2. Taxing the digital economy
3. Indirect tax on e-commerce / China, EU and the Rest of the World
4. MOSS rules in the EU
5. Identification of customers and VAT compliance
6. Virtual currencies
By 2020, it is expected that there will be 30 billion internet connected devices in use.

Many of them ready to “consume” electronic services.
Creative destruction

80% of retail CEOs ranked “technological advances” as one of the top three global trends that will transform their businesses most over the next five years, and 67% of consumer goods CEOs agreed.

Google was founded 16 years ago and Facebook 10 years ago. At that time AltaVista was the most popular search engine and MySpace “the” social media site.

In 2010, MySpace was the 16th most visited website on the Internet.

Altavista was shot down in 2013.

In March 2014, the 915th!
E-commerce market (services and goods)

Annual market growth: 20% - 25%

- Global 2013: 1.3 trillion USD
- US 2015: 470 bio USD
- EU 2015: 300 bio USD
- China 2015: ???

Alibaba stated that in 2013, goods in value of 248b USD were sold already on its marketplaces in China!

Statistics on China are underestimating actual numbers!
Why to watch China?

Economic primacy
GDP at purchasing-power parity, $trn

Sources: International Comparison Programme; IMF; The Economist
*Extrapolated from 2011 onwards

We are here
E-commerce and e-services in China

“In other countries, e-commerce is a way to shop, in China it is a lifestyle.”

Jack Ma – co-funder of Alibaba

China's E-Commerce Market

2010: $74 billion
2013: $295 billion
2017: $713 billion (Estimated)

80% of China’s online shopping market is dominated by Alibaba.

Source: CLSA

Source: iResearch
E-commerce and e-services in China

By 2015, e-commerce transactions in China are estimated to reach USD 540 billion (cca. 10 percent of total retail transactions) ...

- ... and by 2020, China’s e-commerce market is estimated to exceed the US, Britain, Japan, Germany, and France combined. (source: chinamarketwatch.com)
- Alibaba is going to be listed on NYSE (its planned IPO date is rescheduled from "8/8" to Sept 2014) – its gross merchandise value in 2013 (WSJ):

![Gross Merchandise Volume, 2013](graphic)

Because Alibaba runs marketplaces and has a huge customer base, the amount of business that flows over its sites dwarfs that of other e-commerce companies...

*Taobao and Tmall only.
**Total value of all successfully closed transactions.
Source: Forrester Research (Amazon); the companies
Governments want to take their share
Global trend to tax the digital economy

Indirect e-tax development

Direct e-tax development

Taxation of the digital economy
OECD’s BEPS action plan and the digital economy

- 24 March: release of discussion draft on Action 1 - Tax Challenges of the Digital Economy
  - Taxing preparatory or auxiliary activities
  - Definition of permanent establishment
  - IP and transfer pricing
  - Value of data?
- Indirect tax is part of the BEPS program, with the following main issues in this field
  - Identification of the supplier
  - Determining the extent of activities within a country
  - Information collection and verification
  - Identification of customers
OECD’s BEPS action plan and the digital economy

- "Profits should be taxed where economic activities deriving the profits are performed and where value is created..."

“The digital economy is characterized by an unparalleled reliance on intangible assets, the massive use of data (notably personal data), the widespread adoption of multi-sided business models capturing value from externalities generated by free products and the difficulty of determining the jurisdiction in which the value creation occurs..."
Taxing consumption in the digital economy

- China
- The EU
- Rest of the world
In August 2013 China’s “VAT pilot program” was extended nationwide to the transportation and “modern services” industries.

- “Modern services”: the production, broadcast and publication of radio, films and television programs.

From 1 June 2014 further extension for telecommunication services: the VAT rates of 11 percent and 6 percent for “basic telecoms services” and “value-added telecommunications services” respectively will replace the current 3 percent business tax.
Mixed sales of basic and value-added services are not addressed in the legislations → these to be accounted for separately; otherwise all of the VATable services will be subject to the highest VAT rate.

- Practical implications: telecos may not be able to split smartphone charges between “basic” services such as voice calls and “value-added” services such as messaging and data services, as well as to issue invoices with different VAT rates.

It is expected that these changes to the telecommunications sector would reduce profitability for the big three state-owned enterprises that currently monopolize China's telecommunications sector.
Supply of goods ordered online within the EU

Goods are tangible, so their sale can be taxed according the rules of the “old” economy!

Distance selling regime, originally created for catalogue sales in the EU, is reborn and re-applied for e-trading of goods, sold to non-business customers.

Companies need to register for VAT, if their sales to non-business customer in a specific EU member state exceeds a certain threshold (between 35k and 100k EUR).
Supply of goods within the EU
Distance sale

Above these thresholds, sales of goods to private customers in a given country should be taxed according to the local rules, even if delivery is made from the supplier located in another country.

However, still one loophole remains, if the goods are delivered to private customers across customs borders.

Exemption applied, in case of import of goods of low value (depending on the EU member state between EUR 10 and EUR 22)!

This could be relevant for CDs and DVDs!

However this “tax avoidance” will be stopped most effectively by digital transformation, if e-books and digital download of movies and music replace physical media.
Scope of the EU 2015 VAT Changes

Electronic services

Concept of electronic services

• delivered over the Internet or an electronic network
• their supply is essentially automated with minimal human intervention
• impossible to ensure in the absence of information technology

Indicative list of examples to clarify the scope in Implementing regulation

• Services included or excluded specifically

These examples should always be assessed against the above three key features!
EU new rules for telecom, broadcasting and e-services
As of 1.1.2015

EU Company selling to EU B2C Customer

CHANGE !!!

Up to 2014:
VAT due at the place of the seller

2015 rule:
VAT due at the place of the customer

Non-EU Company selling to EU B2C Customer

No change

Current & 2015 rule:
VAT due at the place of the customer

Any Company selling to Non EU B2C Customer

No change

Current & 2015 rule:
No EU VAT; local tax at the place of the customer possible
How to identify your customer status?

As from 1/1/2015, the place of taxation of e-services will be the same for B2B and B2C

But: Identification of customer status is necessary for a business to know whether or not to charge local VAT

- VAT ID number as communicated by customer and successfully verified in EU VIES system can be used as a single tie-breaker
**B2C rules for EU established suppliers**

**As of today**

![Diagram](image1)

- Supplier
- 15% VAT
- Client
- Client
- Client

**From 1.1.2015**

![Diagram](image2)

- Supplier
- 20% VAT
- 20% VAT
- 22% VAT
- Client
- Client
- Client
How to locate your EU consumers?

VAT presumptions

Digital supplies

- The customer residence must be identified using 2 pieces of non-contradictory evidence
- Where no specific presumption could be applied
- Most electronic services fall under this general presumption

Evidence:
Billing address
IP address
Bank details
SIM card country code
Location of fixed land line
Other commercially relevant information
How to locate your EU consumers?
Complex list of presumptions, evidencing and rebuttals

Does the supplier know or should he have known (under normal commercial circumstances) that the supply is made...

- via a telephone box, an internet café, a wi-fi hot spot or similar and is the physical presence of the customer required at the location?
  - yes
    - Is it located on board a means of transport travelling within the EU?
      - yes
        - Place – the country of departure of the journey within the EU
      - no
        - Place – where the telephone box or similar is located
  - no

- via a fixed land line?
  - yes
    - Place – where the fixed land line is installed
  - no

- via mobile networks?
  - yes
    - Place – country of SIM card used to receive the service
  - no

- via a decoder or a viewing card without the use of a fixed land line?
  - yes
    - Place – where the decoder is located or the viewing card is sent to be used
  - no

- with hotel accommodation or similar?
  - yes
    - Place – where the hotel is located
  - no

The supplier could not and should not have known whether the supply was made via any of the above mentioned channels

Place – identified with 2 items of non-contradictory evidence

Rebuttals:
1) if desired by the supplier with 3 items of non-contradictory evidence;
2) by a tax administration in case of indications of abuse or misuse

Rebuttals by a tax administration in case of indications of abuse or misuse
MOSS (Mini One Stop Shop) from 2015

Basic information

• A single return and payment system for cross-border B2C supplies following the 2015 changes.

• Two schemes depending on supplier’s place of establishment – the “Union” and “non-Union” schemes.

• The Union scheme is open to businesses with a business establishment or a fixed establishment in the EU

• The non-Union scheme is open to non EU established and non VAT registered in the EU

• Optional; however once “opted in” bound to report all supplies of relevant services through MOSS in all Member States where that business has no fixed establishment.

• Local rules still apply with regard to invoicing, VAT liability, rates, time of supply, corrections, bad debt, penalties, etc.
# MOSS vs. Direct Registrations

<table>
<thead>
<tr>
<th>MOSS</th>
<th>Direct Registrations</th>
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<tbody>
<tr>
<td><strong>Single registration with limited costs</strong></td>
<td><strong>Number of registrations</strong></td>
</tr>
<tr>
<td><strong>Single VAT return per quarter</strong></td>
<td><strong>Up to 27 additional registrations for EU businesses</strong></td>
</tr>
<tr>
<td><strong>Single set of rules regarding filing deadlines.</strong></td>
<td><strong>VAT reporting</strong></td>
</tr>
<tr>
<td><strong>No input VAT recovery via MOSS. (Must do 8th/13th Directive claims)</strong></td>
<td><strong>Compliance</strong></td>
</tr>
<tr>
<td><strong>Input tax recovery</strong></td>
<td><strong>Required to meet rules of each Member State regarding deadlines.</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Directly via local VAT returns</strong></td>
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</table>
What about the rest of the world?

They are reacting:

Switzerland, Norway, Iceland (pro-acting?): As similar rules already implemented

Some other European countries, such as Russia and Turkey are also following: Similar rules implemented or in development

South Africa: Similar rules from June 2014

Canada: Public consultation on taxation of digital imports
What about the rest of the world?

US

At present:

- Residents of the 45 states with sales and use tax (SUT) must pay tax on their online purchases;
- Retailers, including catalog and online sellers, only need to collect SUT for states where they have a physical presence;
- “Click-through” nexus in several states.

Market Fairness Act 2013 – accepted by US Senate, but not by the House of Representatives:

“To restore States' sovereign rights to enforce State and local sales and use tax laws, and for other purposes. “

Taxation of the digital economy
PwC
Virtual currencies?
The rise of virtual currencies

The Big Picture Behind the News of China’s Bitcoin Bans
by RUBEN ALEXANDER on MAY 6, 2014

HMRC scraps VAT on virtual currency Bitcoin

Germany plans tax on bitcoin after virtual currency recognised as 'private money'

Cryptocurrencies are ‘Inevitable’, Says Google’s Jared Cohen

China's first bitcoin ATM debuts in Shanghai

Updated: 2014-04-17

Taxation of the digital economy
PwC

2014
Slide 29
The rise of virtual currencies
A brief history in time

“If the banks don’t change, we’ll change the banks.”
Jack Ma, co-founder of Alibaba

- Alipay (part of Alibaba), launched in 2004 with no transaction fees
- Biggest market share in China: 300M users & it controls approx. 50% of the Chinese online payment market *(Credit Suisse – Feb. 2014)*
- Provides an escrow service – payment only released to seller if the customer is happy with the goods purchased
- Money market fund Yu’E Bao - $41 billion in assets under management
The rise of virtual currencies

Approximately 8 million wallets forecasted by Dec. 2014

Sources and Notes: total wallets based on data from Blockchain.info, MultBit.org, Coinbase.com, Andreas Schildbach (Android Bitcoin Wallet developer), Historical Coinbase data provided by BitcoinPulse.com.
Virtual currencies
New virtual currency

Litecoins, Peercoins,
Ripples, Dogecoins, Mastercoins, Nxts, Namecoins, BlackCoins, Bit-Shares-PTS, Quarks, Primecoins, Counterparties, Feathercoins, Marinecoins, Zetacoin, Vertcoins, Megacoin, DarkCoins, Novacoin, Infinitecoins,
WorldCoins, MaxCoins, YbCoins, FlutterCoins, WhiteCoins,
Ixcoins, Mintcoins, Billioncoins, Auroracosins, Devcoins, Anoncoins,
PotCoins, Faircoins, Terracosins, Zeitcoins, CommunityCoins, Applecoins,
Tickets, GoldCoins, Nases, Digitalcoins, Freicoins, HoboNickels,
Unobtainiums, Particles, NetCoins, ECCoins, USDes, UltraCoins, Myriadcoins,
NobleCoins, UnionCoins, Cryptogenic Bullion, CaiShen, Mona-
Coins, AsiaCoins, SecureCoins, Einsteiniums, Coins 2.0, MicroCoins,
FedoraCoins, BitBars, BBQCoins, Mincoins, Karmacoin, TagCoins,
RedCoins, ReddCoins, Saturncoins, DigiBytes, HunterCoins, Sexcoins,
Heavycoins, Kittehcoins, MemoryCoins, MazaCoins, Bitcoin Scrypts,
Riecoins, Yacoins, Pawncoins, Mooncoins, Execoins, Hirocoins, Top-
Coins, LottoCoins, Fastcoins, DopeCoins, EarthCoins, KlondikeCoins,
Isracoin, FlappyCoins, Deutsche eMarks, 42 Coins, GroestlCoins, Pandacoin,
Diamonds, Blakecoins, TeslaCoins, DNotes, etc.
Virtual currencies
New virtual currency

- 17 July 2014 – new virtual currency (CZC) created in the Czech Republic
- Server attacked by hackers on the very first day
- Main goal declared by founders – support of e-business in the Czech Republic
- 50% of the coins is pre-mined
- 19 August – first set of pre-mined 100,000 CZC offered to public (sold out within 9.5 hours!)
- Until August 29th, a new set of pre-mined 100,000 CZC will be offered to public as soon as the previous set is sold out
- August 29th – exchange platform will start on the official website of CZC
- Final amount of coins (100 million) will be reached within 4-10 years
Virtual currencies
How does it work

- Bitcoin - first decentralized digital currency (21 million coins)
- Value determined by the market
- Peer-to-peer network (no central authority; all functions performed by network; anybody can join)
- All operations recorded in a public database called block chain
- New block added to the chain when cryptographic algorithm is solved by miners
- New Bitcoin generated to the miner when new block is attached to the chain
# The rise of virtual currencies

**Pro’s and con’s for companies**

<table>
<thead>
<tr>
<th>Pro’s</th>
<th>Con’s</th>
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<tbody>
<tr>
<td>Low transaction fees</td>
<td>No central entity backing it</td>
</tr>
<tr>
<td>No payment reversals</td>
<td>Dynamic product pricing</td>
</tr>
<tr>
<td>Easy to set up</td>
<td>No legal tender in some countries</td>
</tr>
<tr>
<td>Daily cash outs (almost instant)</td>
<td>Tax treatment (uncertain depending on transaction)</td>
</tr>
<tr>
<td>New customers (community)</td>
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No official VAT / tax treatment of virtual currencies in China

Central Bank of China: “Bitcoin is not a currency” – Dec 2013

The current approach discourages the use and the servicing of Bitcoin payments for 3rd party payment providers

Key concerns of the Chinese government:

- money-laundering,
- capital controls,
- lack of fundamental value,
- extreme price swings
Virtual currencies
Pro’s and con’s for customers
Virtual currencies
Ecuador/Australia (tax guidance on bitcoin published on 20 August 2014)

- **Ecuador** intends to introduce its own virtual currency which would be however acknowledged as a legal tender.

  Since 2000 Ecuador’s legal tender is the US Dollar (the original legal currency - Sucre was abolished after hyperinflation)

  New law introducing the virtual currency as a legal tender was accepted by the Parliament and now needs solely the President’s signature in order to enter into force.

- **Australia** bitcoin and other cryptocurrencies are not money or foreign currency for taxation purposes.

  Income from mining bitcoin (provided that the taxpayer is in the bitcoin mining business) is included in the taxpayer's assessable income, and expenses incurred in respect of the mining will be deductible.

  Bitcoin may be trading stock where it is held for the purpose of sale or exchange in the ordinary course of a business.

  Bitcoin is a CGT asset, however the treatment of bitcoin used for personal purposes (e.g. for acquiring goods and services) is similar to the treatment of other assets, whereby any capital gain or loss from disposal of the bitcoin is disregarded provided the cost of the bitcoin is AUD 10,000 or less.

  Salary or wages paid in bitcoin will be treated as a fringe benefit and subject to the Fringe Benefits Tax.

  Transfers of bitcoin are supplies for GST purposes, but not financial supplies.
## VAT specific related issues to Virtual currencies

<table>
<thead>
<tr>
<th>Transaction</th>
<th>Remuneration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sending BTC to the BTC exchange</td>
<td>BTC exchange will receive a transaction fee</td>
</tr>
<tr>
<td>BTC are sold on the BTC exchange</td>
<td>Transaction takes place and is taken care of by the miners</td>
</tr>
<tr>
<td>Network transaction fee (fee for creating a BTC block)</td>
<td>Seller receives $ on his bank account</td>
</tr>
</tbody>
</table>

### FROM COINS TO BANK: SIMPLE AND FAST
- **Send Bitcoins from your wallet**
- **Bitcoin Transaction Confirmation**
- **Bank Transaction Confirmation**
- **Cash available on your bank account**
VAT issues related to virtual currencies
What should the VAT treatment be?

VAT Considerations:
- Establishing the nature of the supply – what is it?
- Is the supply single or composite?
- Who is supplying services to whom and for what consideration?
- Determining the applicable VAT treatment i.e. taxable, exempt or non-business?
- What does this mean for VAT recovery?
**VAT issues related to virtual currencies**

**EU Tax authorities statements on the treatment of BTC**

Exchange of BTC for goods/services – VAT applicable to these supplies as usual

What should the VAT treatment of BTC and activities relating to BTC be?

- **Germany** - VAT exemption applicable on BTC exchange
- **Netherlands** - no clear guidelines on VAT
- **UK** - VAT exemption applicable on BTC exchange
If you are interested to know more on these topics

- http://ebiz.pwc.com/
- http://michaelamerz.org/
Annex
Scope and limitations of the EU 2015 VAT Changes
Electronic services in the VAT Directive Annex II

- Website supply, web-hosting, distance maintenance of programs and equipment
- Supply of software and updating thereof
- Supply of images, text and information and making available of databases
- Supply of music, films and games, including games of chance and gambling games, and of political, cultural, artistic, sporting, scientific and entertainment broadcasts and events
- Supply of distance teaching
**Scope and limitations of the EU 2015 VAT Changes**

**Electronic services affected**

**Some inclusions to note**

- On Demand programme services and streamed radio or TV that is only provided over the Internet
- Search engines: Services of price comparison and similar websites
- Accessing or downloading of images, music or films
- Games, including games of chance and gambling games
- Online auction services
- Distance teaching / virtual classrooms
- Internet Service Packages (ISPs) in which the telecommunications component is an ancillary and subordinate part
- ...
**Scope and limitations of the EU 2015 VAT Changes**

**Electronic services not affected**

**Some exclusions to note:**

- Supply of goods, where only the order and processing is done electronically
- Services of professionals who advise clients through email
- Interactive teaching services where the course content is delivered by a teacher over the internet or an electronic network (i.e. via remote link)
- Offline data warehousing services
- Certain events and other services of a tangible nature, booked online
  - Online provision of tickets to cultural etc. or similar events
  - Online booking of hotel accommodation and the like
MOSS (Mini One Stop Shop) from 2015

Definitions

Member State of Establishment (MSE)

- EU country where a company has a fixed establishment.
- Cannot report supplies in MSE through MOSS.

Member State of Identification (MSI)

An EU country where the company has:

- its business establishment (for EU businesses under the Union scheme), otherwise;
- has a fixed establishment (for non-EU businesses under the Union scheme),
- or by choice (for the non-Union scheme).

Member State of Consumption (MSC)

- The EU country where a customer is deemed to receive the services. Local rules prevail in MSCs.
- Under non-Union scheme MSI could also be a MSC.