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DIGITAL ECONOMY TAXATION UPDATES

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WHAT IS DIGITAL ECONOMY?

“the result of a transformative process brought by information and communication technology (ICT), which has made technologies cheaper, more powerful, and widely standardised, improving business processes and bolstering innovation across all sectors of the economy”

- BEPS Action 1, 2015

Three characteristics of highly digitalised business models:

1.1. Scale without mass

2. A heavy reliance on intangible assets

3. Data and user participation

TIMELINE

OECD **Action Plan** on BEPS

July 2013

BEPS Action 1 Report

Oct 2015

TFDE Meeting

March 2018

Interim Report (Action 1)

July 2018

Final Report (Action 1)

2020

ISSUES ON
DIGITAL ECONOMY TAXATION

1. NEXUS

- **Where** tax should be paid?
- Significant digital presence, where value is created without any physical presence

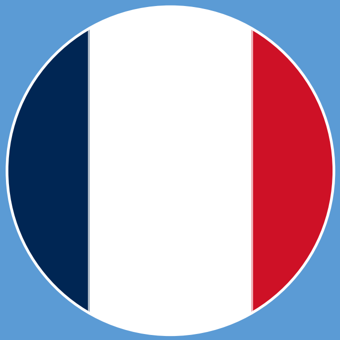
2. PROFIT ATTRIBUTION

- **How much** does the tax liable?
- Allocation of taxing rights

TFDE MEETING PROPOSALS

"The User Participation" Approach

"The Marketing Intangibles" Approach



Global Anti-base Erosion Proposal

Global Anti-base Erosion Proposal

VALUE CREATION ON DIGITAL ECONOMY

UNRESOLVED BEPS ISSUES

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THE UNITED KINDOM
“The User Participation” Approach

Policy Rationale	the **sustained engagement** and **active participation of user**s is a critical component of value creation for certain highly digitalised businesses
	Social media platforms, search engines, and online marketplaces
Mechanics	An amount of profit be allocated to jurisdictions in which those **businesses’ active** and **participatory user bases** are located
	Calculated through a non-routine or **residual profit split approach**
Other countries comments	**Conversion methodology** as another possible approach of measuring the attributable profit
	Developing **clear boundaries (threshold)** that would exclude business that do not rely on user participation to make profit

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THE UNITED STATES
“The Marketing Intangibles” Approach

Policy Rationale	Sees an intrinsic functional link between **marketing intangibles** and the **market jurisdiction**
	Three key fact patterns: does not have a taxable presence, **or** has a local presence but operates as an LRD, **or** consumer product business not traditionally thought of as a highly-digitalized business, operating either remotely or through an LRD structure
Mechanics	Modify current profit allocation and nexus rules to require that the non-routine or residual income of the MNE group **attributable to marketing intangibles and their attendant risks** be allocated to the market jurisdiction
	Determine marketing intangibles whether allocated under the current rules of the TPG **or** to the market jurisdiction. Then calculated under a revised **residual profit split analysis**
Other countries comments	**New approach** should take into account the conclusions of recent work on the contribution made by **DEMPE functions** (Actions 8-10)
	The existing guidance on the remuneration of distribution activities, and **should remain consistent** with the existing tax framework including the arm’s length principle

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POTENTIAL DESIGN OF
UNIFIED APPROACH

Amending or supplementing the Article 5 definition of “PE”

The profit (or loss) to be re-allocated to the relevant **user** or **market jurisdictions**

Apportioned based on an **agreed allocation metric**

A **new type** of Residual Profit Split method

FRANCE AND GERMANY
Global Anti-Base Erosion Proposal

Background	The proposal recognises that there is **a risk** of un-coordinated unilateral action, in the absence of multilateral action
	Therefore, a **multilateral framework** to achieve a balanced outcome which makes business location decisions less sensitive to tax considerations, limit compliance and administration costs and avoid double taxation
Two inter-related rules as solution	**Income inclusion rule** as a minimum tax by requiring a shareholder in a corporation to bring into account a proportionate share of the income of that corporation if that income was not subject to tax at a minimum rate **(supplement the CFC rules)**
	Tax on base eroding payments which include an **undertaxed payments rule** that would deny a deduction for a payment to a related party if that payment was not subject to tax at a minimum rate and **a subject to tax rule** in tax treaties that would only grant certain treaty benefits if the item of income is sufficiently taxed in the other state. (Art 7, 9, 10, 11-13, and 21)
Other countries comments	Need a **further work** to clarify the kinds of entities, arrangements and behaviours that are within the intended scope of the global anti-base erosion proposal
	Considering **safe-harbours** and **thresholds** that would reduce complexity in the application of the rule
	Co-ordinating outcomes and the possibility of incorporating dispute prevention and resolution components

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G-24 Working Group Proposal

Modification in PE threshold

- The G-24 countries are of the view that if a business is able to interact extensively with customers in a market jurisdiction and generate business profits without physical presence, it **should give rise to existence of PE**,
- The market jurisdiction should be able to tax such business income on net basis. For this, the **modification in PE threshold** and **associated profit attribution rules** would be required

Revision on Nexus rules

- The concept of **Significant Economic Presence** (SEP) in Art 5
- Revenue generated on a **sustained basis** from a jurisdiction
- The **user base** and the **associated data input**
- The **volume of digital content**
- Others (like billing and collection in local currency, website in local language, etc)

Principles for Profit Attribution

- Value is created in the market where the **customer**s are located (as evident from California orange example, report to the League of Nations)
- Value and profits for the enterprise can be generated by **"users"**
- The participation of the user can be low, medium, or highly depending on the value of the user action
- Another possible way is the **fractional apportionment**

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INDONESIA POSITION

A New **Nexus** based on Significant Digital Presence should be established

Modification of the definition of "PE" is needed

Legislate the Digital Transactions (E-commerce)

The Producers and market jurisdiction are the locations where the DE value is created

Profit allocation between producer and market jurisdiction in proper manner

Protecting the Interest of Indonesia for the Benefit of Indonesian

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