MACROECONOMICS, TRADE AND INVESTMENT

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EQUITABLE GROWTH, FINANCE & INSTITUTIONS INSIGHT

Digital services tax: country practice and technical challenges

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ABSTRACT

Several countries have introduced, or are considering introducing, digital services taxes (DSTs). They seek to tax either income or profit of online digital platform owners and/or online service providers. This paper describes and compares the main features of these rules as well as implementation mechanisms. The international tax policy context in which the rules are introduced is presented as part of an assessment of DST's policy objectives, theoretical underpinnings, and limitations. The paper does not seek to either recommend or advise against the adoption of DSTs but explores their role as taxes on service provision by non-residents. It is instructive to analyze their policy objectives, and relationship with existing principles of international taxation, in that framework.

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Contents

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Introduction

Digital platforms are transforming social, business, and economic norms, changing the way we interact, consume, and do business. Digital technologies present many opportunities and benefits for society and governments. They also provide new opportunities for tax administrations, such as prospects for better and more efficient tax collection by accessing new data sources and improved international collaboration.[1]

Digital transformation, however, is also raising challenges, including placing unprecedented stress on international tax rules. Traditional principles governing taxation rights and profit allocation place significant emphasis on physical features of businesses, including the location of people and assets. These rules, developed in the early 20th century, are problematic in an age when businesses conduct significant economic activity in a country through digital platforms, with little or no physical presence, leveraging local markets, users, and data to realize business value.[2]

Digital companies are also disrupting traditional domestic markets. Technological advances in internet and telecommunications, and changing social trends, have resulted in digital businesses quickly increasing their international presence. According to the European Commission, the average annual revenue growth of the top digital firms is 14% compared to between 0.2% and 3% for other multinationals.[3] Increasingly, these businesses are at the heart of economic activity in sectors such as transport, accommodation, advertising, entertainment, and retail sales. Differential tax treatments of digital and traditional businesses models create potentially unfair competitive environments.[4]

The ongoing COVID-19 pandemic is amplifying many of these trends and challenges. Lockdowns and social distancing restrictions have accelerated digital transformation, forcing many activities online. These sudden adjustments made by many societies have built up significant momentum and are likely to have lasting effects on digital business models. The economic disruption caused by the pandemic has forced governments into significantly increased expenditures at a time when GDP and tax revenues will be greatly diminished.[5] Governments will

1 For example, the OECD's (2020) Model Rules for Reporting by Platform Operators with respect to Sellers in the Sharing and Gig Economy. http://www.oecd.org/ctp/exchange-of-tax-information/model-rules-for-reporting-by-platform-operators-with-respect-to-sellers-in-the-sharing-and-gig-economy.pdf

2 For a detailed discussion see OECD (2018), Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris

3 European Commission, Digital Tax Reform Fact Sheet, 2018 accessed at https://ec.europa.eu/taxation_customs/sites/taxation/files/factsheet_digital_taxation_21032018_en.pdf. However, an IMF paper also demonstrated that, out of the Fortune Global 500 companies, technology companies have lower profit margins than companies from other sectors, including Banking, Telecommunications and Pharmaceuticals. See Aslam and Shah, "Tec(h)tonic Shifts: Taxing the Digital Economy", IMF Working Paper, May 2020.

4 "Leveling the playing field" was one of the aims of the EU Digital Tax Proposal and discussed in other jurisdictions such as Australia's "The digital economy and Australia's corporate tax system: Treasury Discussion Paper", October 2018 and New Zealand's "Options for taxing the Digital Economy: A Government Discussion Document" June 2019.

5 World Bank "Global Economic Prospects" June 2020

need to explore all options for securing and increasing their tax revenues as they look to rebuild public finances as they emerge from the pandemic. Consequently, securing a larger digital tax base is increasingly becoming a policy priority.

As digital transformation accelerates many countries are grappling with policy responses to ensure fair and efficient taxation of digital businesses. Digital platforms present unique challenges for policymakers and tax administrations in the context of both income taxes and consumption taxes. The propensity of digital platforms to generate economic scale without physical mass and to rely on non-traditional and mobile value drivers and revenue streams exacerbates these challenges. A major concern is that companies with digital business models appear to have a much lower effective tax rate than traditional competitors.[6]

The taxation challenges created by the digital economy have been the subject of debate for over 20 years and recently gained political attention with the OECD/G20 BEPS project. In 1998 several principles, including broad taxation principles applicable to electronic commerce,[7] were endorsed at an OECD Ministerial Conference[8]. Follow up work resulted in the development of several recommendations relating to the taxation of the digital economy and an update to the Commentary of the OECD Model Tax Convention.[9] For the most part, these related to the extent to which a server can constitute a Permanent Establishment ('PE'), and, if so, the amount of profit that could be attributed to it. More recently, the tax challenges presented by the digital economy were the subject of the OECD/G20 BEPS initiative[10], with follow-up work conducted by the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (Inclusive Framework)[11] and consideration of the issues by the UN ('UN') Committee of Experts.[12] Recent years have also seen several countries and regional organizations (most notably the European Union and African Tax Administration Forum) develop unilateral or regional approaches, typically in the form of 'digital services taxes' ('DST's) that are the subject of this paper.

In respect of the taxation of income, international debate is currently focused primarily on the work taking place within the Inclusive Framework. In October 2019, the Inclusive Framework released a proposal, developed by the OECD Secretariat, termed the 'Unified Approach'. This outlines two proposals for addressing the tax challenges of the digitalization of the economy. Pillar 1 proposes a mechanism for creating an expanded nexus linked to the market, including cases where there is no physical presence of a non-resident in the jurisdiction. The Pillar 2 proposal outlines anti-avoidance rules that would effectively impose a global minimum tax. Neither proposal now seeks to ringfence the digital economy; instead they apply to the largest MNE taxpayers, irrespective of the level of digitalization. In October 2020, the Inclusive Framework released the Pillar 1 and Pillar 2 Blueprints, which described the key design features of each proposal and identified the issues that remained unresolved. The Inclusive Framework initially sought to reach a consensus by the end of 2020, although this proved not to be possible and the timeline was extended well into 2021. On July 1st, 2021 an initial statement was released by 130 (of 139) members of the Inclusive Framework, outlining the agreed components of the two-pillar solution as at that date (The 'July 2021 statement').[13] On October 8th, 2021, 136 members signed an updated version of the statement (The 'October 2021 statement').[14] This statement includes a commitment by the participating countries to remove existing unilateral measures, such as DSTs, and to not introduce new such measures in the future. [15] Technical work on the development of Pillars 1 and 2 continues at the OECD, with the goal of making their main elements effective in 2023.

While the Inclusive Framework's 2021 statements are encouraging, the path ahead remains uncertain. With many key components still to be developed, there may still be challenges in finding consensus and in designing an implementation mechanism. Unilateral measures may therefore continue to be an important policy option for Inclusive Framework members for some time. It should also be noted that a small number of Inclusive Framework members (such

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6 European Commission, Digital Tax Reform Fact Sheet, 2018 accessed at https://ec.europa.eu/taxation_customs/sites/taxation/files/factsheet_digital_taxation_21032018_en.pdf, however others argue that findings on lower effective rates are misleading suggesting that digital business models have similar, or slightly higher effective tax rates than traditional business models, for example Dr. Matthias Bauer, "Digital Companies and Their Fair Share of Taxes: Myths and Misconceptions," ECIPE Occasional Paper, March 2018, or Bathia, Karan "It's time for a new international tax deal"https://www.blog.google/outreach-initiatives/public-policy/its-time-new-international-tax-deal/.

7 http://www.oecd.org/ctp/consumption/1923256.pdf; OECD 1998

8 "A Borderless World: Realising the Potential of Electronic Commerce", held in Ottawa.

9 http://www.oecd.org/tax/consumption/Taxation%20and%20eCommerce%202001.pdf; OECD 2001

10 Addressing the Tax Challenges of the Digital Economy. https://www.oecd-ilibrary.org/taxation/addressing-the-tax-challenges-of-the-digital-economy_9789264218789-en; OECD 2015.

11 The OECD/G20 Inclusive Framework on BEPS consists of 139 countries and jurisdictions, drawn from OECD member and non-member countries, on an equal footing, to take discuss and develop multilateral international tax rules.

12 Committee of Experts on International Cooperation in Tax Matters, Subcommittee on Tax Challenges Related to the Digitalization of the Economy.

13 https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf.

14 https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf

15 The Multilateral Convention (MLC) will require all parties to remove all Digital Services Taxes and other relevant similar measures with respect to all companies, and to commit not to introduce such measures in the future. No newly enacted Digital Services Taxes or other relevant similar measures will be imposed on any company from 8 October 2021 and until the earlier of 31 December 2023 or the coming into force of the MLC.

as Kenya and Nigeria) have not yet registered their agreement with the statement, and many other countries are outside of the Inclusive Framework structure. These countries, in particular, may look to introduce new measures (such as DSTs), or refine existing measures, to ensure source taxation of digital service providers.

To date, at least 20 countries have acted unilaterally to implement measures to tax income from digital services. These measures vary in their objective and scope; some target all businesses while others target specific digital revenue streams or digital business models. Some build on existing income tax rules, others represent a new stand-alone tax. What they have in common, however, is the objective of taxing some part of the income of large multinational enterprises conducting business through online digital platforms. It should be noted, however, that many countries are successfully applying consumption taxes (VAT and GST) on digitally provided goods and services. In some cases, countries have implemented both consumption tax and income tax measures to cover digitally provided goods and services. In addition, some countries have introduced financial transaction taxes, partly in response to the increase in online payments. Consumption taxes and transaction taxes are outside the scope of this paper. This paper discusses just the first type of taxes, on income from the provision of services through online digital platforms.

Income tax policy responses include comprehensive DST rules, such as those enacted by Austria, France, Italy, Paraguay, Spain, Turkey, UK and Uruguay. Some countries have focused on withholding tax rules to capture payments to non-residents for digital services while other countries, such as Nigeria, Indonesia, and Israel, have expanded domestic PE definitions (nexus rules) to cover "virtual PEs". At the international level, the EU in 2018 proposed a DST in respect of a range of digital services and in August 2020 the UN issued a draft new Article to its Model Tax Convention (Article 12B)[16] which would allow a country to tax payments for certain digital services made to a resident of a treaty partner. In October 2020, the UN Committee of Experts on International Cooperation in Tax Matters agreed to adopt the new Article 12B and in April 2021 its final form for inclusion in the UN Model Tax Convention was settled. September 2020 saw the African Tax Administration Forum (ATAF) issue its "Suggested Approach to Drafting Digital Services Tax Legislation"[17].

The purpose of this paper is to survey and analyze country level responses and ongoing developments with respect to income taxation of the digital economy. The paper considers recent literature and developments in global fora, as well as policy steps taken by individual countries. In doing so, it analyzes the extent to which the policy objectives behind recently adopted unilateral measures diverge from, but also align with, those underpinning existing international income tax principles. The paper discusses the 'gap' between the unilateral approaches adopted to date and existing principles, which recent innovations aim to bridge.

There are many conceptual justifications for measures which tax the income of digital service providers. This paper focuses on policy foundations that are grounded in international tax principles - as embodied in model tax conventions and bilateral treaties, and country practice with respect to domestic tax rules. There are, however, a range of other conceptual or economic justifications, which are not considered by this paper. For example, many commentators suggest that users of digital platforms play a significant role in value creation, justifying the designation of source-based taxing rights to the jurisdiction in which they are located.[18] Others suggest that the digital platforms earn significant amounts of location-specific-rents from a jurisdiction[19] and the IMF has suggested that user data is analogous to a commodity, and could be taxed like other commodities (for example mineral royalties).[20] It can also be argued that digital platforms benefit significantly from local market infrastructure (such as broadband and other technology, educated population etc), and should contribute to their costs.

In drawing on the existing international tax framework, to a large extent, this paper examines DSTs in the context of service provision. It is plausible to characterize numerous digital transactions as the provision of a service, but it is arguable that some digital transactions give rise to the consumption of a digital good. These include services provided to a buyer or seller on an online marketplace, an advertiser placing adverts on a digital platform, a driver using an online booking app, a hotel or travel provider utilizing online booking platforms, and individuals or businesses purchasing cloud computing services. DSTs typically seek to tax the fees derived from these services. This framework provides a clear and direct route to taxation of the digital economy, based on the income derived by digital service platforms from residents of, or users located in, a country. The paper suggests that

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16 https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-08/TAX%20TREATY%20PROVISION%20ON%20PAYMENTS%20FOR%20DIGITAL%20SERVICES.pdf
17 https://events.ataftax.org/index.php?page=documents&func=view&document_id=79
18 See for example Aslam and Shah, "Tec(h)tonic Shifts: Taxing the Digital Economy", IMF Working Paper, May 2020.
19 See for example Cui, Wei, The Digital Services Tax: A Conceptual Defense (April 22, 2019). 73(1) Tax Law Review 69-111 (2019).
20 IMF Policy Paper: Corporate Taxation in the Global Economy. https://www.imf.org/en/Publications/Policy-Papers/Issues/2019/03/08/Corporate-Taxation-in-the-Global-Economy-46650

jurisdictions may be able to apply their DSTs directly to the fees paid by their citizens to providers of these types of digital services. However, DSTs can also be applied to fees paid to service providers that are referable to a jurisdiction but are not paid directly by persons located in, or residents of, the jurisdiction. For example, a business in country A that pays fees to a digital platform in country B to advertise its services to users in country C could be subject to country C's DST.

Existing principles concerned with the taxation of non-resident service providers, found in the OECD and UN model tax conventions, may provide a strong conceptual framework for analyzing DSTs. An examination of these principles reveals that they have not been fully reflected in the way tax systems are generally designed. This has left a gap between common practice and the effective and principled taxation of the digital economy. That gap may not be unbridgeable, and it is arguable that there are already overlaps. DSTs can be viewed as attempting to bridge the gap, recognizing that they derive from the nature of the digital economy rather than any significant normative shift. Much more work needs to be carried out, including on the definition of the term 'services', and the distinction between 'service provision' and 'consumption'. In addition, a DST typically, and from a practical point of view necessarily, aims to tax revenue rather than profit. The fact that DST (and similar measures) generally tax revenue, raises questions about the implication for tax treaties, which cover taxes on income and capital.

In examining country level responses, the paper considers key issues with respect to the design of income tax measures that target the digital economy. The paper recognizes that, whilst a multilateral solution is ideal, many countries have already advanced their domestic tax rules to capture certain digital services. These country level responses may provide the most practical reference point and legislative framework for policy makers. Although the Inclusive Framework's July 2021 statement is encouraging, these measures will continue to be relevant for non-members, and even for Inclusive Framework members, at least until such time as the solution is implemented. The paper therefore builds on the commentary contained in an earlier discussion paper[21], which assessed the various options and proposals to reform the global tax rules.

This paper does not provide overall guidance on the desirability of DST or other income tax measures in response to the digitalization of the economy. Nor does it consider the potential revenue effects of such measures.[22] Instead, it summarizes the responses to date and provides an analysis that can inform policy development by developing economies as they assess the legislative and administrative responses available to them.

21 Clavey, Colin John; Leigh Pemberton, Jonathan; Loeprick, Jan; Verhoeven, Marinus. 2019. International Tax Reform, Digitalization, and Developing Economies . MTI discussion paper, no. 16. Washington, D.C. : World Bank Group.

22 Specific revenue estimates have been published by some governments or organizations that have introduced or proposed DSTs. In 2018 the European Commission estimated that €5 billion could be raised from their proposal of a 3 percent tax on revenues from digital companies. The UK Government estimated that their DST would raise £275 million. For a discussion, see Aslam and Shah, "Tec(h)tonic Shifts: Taxing the Digital Economy", IMF Working Paper, May 2020.

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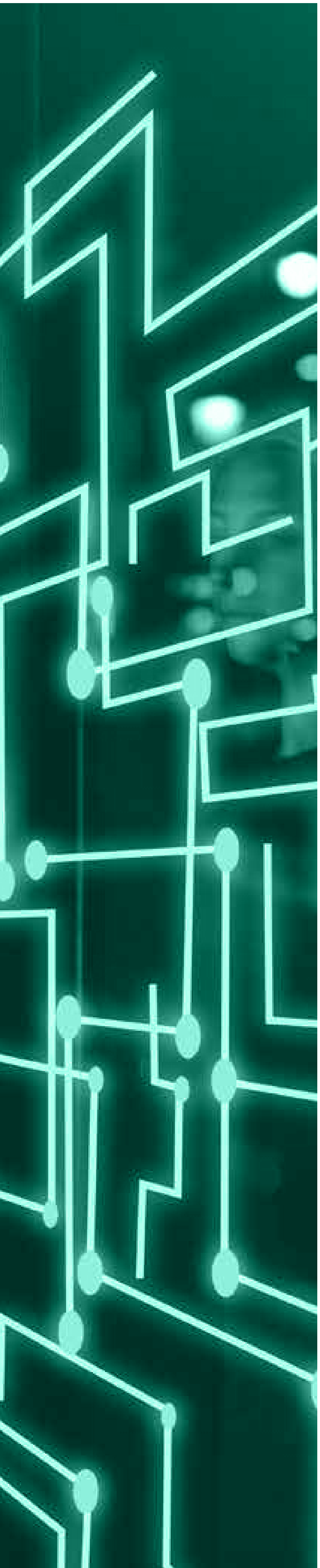

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Developing a framework for the taxation of the digital economy

2.1 INTERNATIONAL CONTEXT

The challenges associated with developing a mechanism for taxing income arising from the digital economy are increasingly acute, but not new.[23]At the international level, the OECD has been leading the search for a global consensus on a multilateral approach through the work undertaken within Action 1 of the OECD/G20 BEPS initiative. This work is now led by the Inclusive Framework. At the same time, several countries, as well as international and regional organizations, have developed, or are in the process of developing, unilateral or regional approaches.

Work has also been conducted at international and country level on the imposition of consumption taxes, such as VAT and GST, on digitally provided goods and services. This strand of work is outside the scope of this paper, which focuses on income taxes (including taxation of income on a gross basis) rather than consumption taxes. However, there is international consensus on the imposition of VAT and GST on digitally provided services, and more than 50 countries have successfully introduced consumption taxes on digitally provided goods and services. Consumption taxes seek to tax consumers, whereas DSTs seek to tax the income or profit of businesses operating highly digitalized business models. Aspects of the approaches taken to the indirect taxation of the digital economy, however, may be relevant to direct tax solutions, including the mechanisms used for reporting and paying taxes.

Efforts to develop a multilateral consensus on a mechanism to tax the profit of multinational enterprises operating in the digital economy are ongoing. The initial conclusions of the G20/OECD's BEPS project[24] did not envisage it would be feasible to ring-fence the digital economy for the purposes of taxation, and generally considered that other BEPS measures, such as changes to the treaty rules on PEs and revised guidance on transfer pricing, together with consumption taxes, would provide sufficient coverage and protection.[25] Further input by Inclusive Framework members, however, called for a more innovative and wide-reaching approach, resulting in a proposal (termed the 'Unified Approach') developed

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23 Discussions at the international level took off during the late-1990s. See: http://www.oecd.org/ctp/consumption/1923256.pdf; OECD 1998

24 , 'Addressing the Tax Challenges of the Digital Economy' OECD, October 2015. https://www.oecd-ilibrary.org/doc-server/9789264241046-en.pdf?expires=1591690743&id=id&accname=guest&checksum=85857A9A27A8A4FD6F-DE07F838ECF649

25 Specifically, it concluded that options which included revisiting existing principles, such as "(i) a new nexus in the form of a significant economic presence, (ii) a withholding tax on certain types of digital transactions, and (iii) an equalization levy", were not recommended at that stage.

by the OECD Secretariat.[26] Pillar One of the proposals puts forward an innovative mechanism, not restricted to the digital economy, for allocating MNE profit between tax jurisdictions. The proposed mechanism is envisaged to operate in addition to traditional transfer pricing rules. At a high level, it is designed to identify a portion of an MNE's global profit attributable to market-based factors (dubbed "Amount A") and allocate that portion between the jurisdictions in which the MNE operates. This allocation will, broadly, be based on sales in the end-market where goods or services are used or consumed. To an extent, this mechanism departs from existing international taxation practices in that it proposes a formulaic mechanism for the allocation of global profits of MNEs, in contrast to traditional transfer pricing mechanisms, which apply on a case-by-case basis. In addition, it is grounded in a new revised concept of a nexus, which, in contrast to existing principles, does not make a country's taxation rights wholly contingent on the physical presence of an MNE.

The 'Unified Approach' has both strengths and weaknesses.[27] It bears little relation to the DSTs discussed in this paper and does not seek to recognize a specific source-country right to tax income arising from digitally provided services. Amount A of the unified approach allocates a potentially larger slice of MNE consolidated net profit to market jurisdictions than might result from the application of existing transfer pricing principles alone. The more mechanical and formulaic aspects of the proposed allocation of profit, and those adopted in relation to Amount B[28], however, may be welcomed by countries that struggle to implement the current transfer pricing framework, especially as the approach extends beyond the purely digital economy. The October 2021 statements by 136 members of the Inclusive Framework includes a specific commitment to simplify the application of the arm's length principle to baseline marketing and distribution activities with the needs of low-capacity countries specifically in mind.

Achieving consensus on a multilateral approach to the taxation of the digital economy has been challenging. The United States, in particular, has expressed opposition to digital services taxes and has raised serious concerns regarding departures from the arm's-length principle and any modification to existing principles concerning the taxation of non-residents.[29] However, the new administration in the United States has signaled a renewed desire to reach an international agreement on this issue during 2021.[30]

The OECD has discouraged countries from unilaterally introducing digital services taxes and stressed that any such tax should be temporary, pending consensus on a multilateral approach. The United States also 'firmly opposes proposals by any country to single out digital companies'[31] and in June 2020, the Office of the United States Trade Representative announced the initiation of 'investigations with respect to Digital Services Taxes (DSTs) adopted or under consideration by Austria, Brazil, the Czech Republic, the European Union, India, Indonesia, Italy, Spain, Turkey, and the United Kingdom,'[32] pursuant to section 301 of the Trade Act. This follows the earlier investigation into France's DST which, in December 2019, concluded that the DST was discriminatory against US Digital companies.[33] In January 2021, the United States Trade Representative also concluded that the DSTs of India, Italy, and Turkey were discriminatory, whilst the outcome of the other country investigations were still pending.[34] However, these findings are contested. For example, India's position has been that the equalization levy is non-discriminatory and only seeks to ensure a level playing field for businesses with a taxable presence in the country. India further clarified that the levy is only applied prospectively and does not have an extraterritorial application since it is based on sales that occur in India through digital channels.

The Inclusive Framework's October 2021 statement specifically envisages the removal of all DSTs, and a commitment not to introduce new unilateral measures in the future, conditional on the implementation of Pillar 1[35].

26 https://www.oecd.org/tax/beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf; OECD, October 2019
27 For a detailed discussion of underlying considerations and challenges see: Avi-Yonah, Reuven S. and Clausing, Kimberly A., Toward a 21st-Century International Tax Regime (August 26, 2019). "Toward a 21st-Century International Tax Regime," Tax Notes International, Aug. 26, 2019, pp. 839-849. Or Clavey et al (2019).
28 Amount B is a fixed return on certain baseline marketing and distribution activities.
29 In a letter to the OECD in December 2019 US Treasury Secretary Steven Mnuchin suggested that a mechanism such as that proposed in Pillar 1 of the Unified Approach might be made a safe harbor for taxpayers, which, in this context, means voluntary. It is difficult to envisage that such an approach would be acceptable to members of the Inclusive Framework, or beyond. In June 2020, the United States called for suspension of further talks on Pillar 1: https://news.bloombergtax.com/daily-tax-report-international/u-s-raises-concerns-about-oecds-global-rewrite-plan.
30 "Janet Yellen signals US return to multilateralism in first G7 meeting" Financial Times, February 15, 2021.
31 https://home.treasury.gov/news/press-releases/sm0316
32 https://www.federalregister.gov/documents/2020/06/05/2020-12216/initiation-of-section-301-investigations-of-digital-services-taxes
33 https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/december/conclusion-ustr%E2%80%99s-investigation
34 https://ustr.gov/about-us/policy-offices/press-office/press-releases/2021/january/ustr-releases-findings-dst-investigations
35 The October 2021 Inclusive Framework statement specifies that 'no newly enacted Digital Services Taxes or other relevant similar measures will be imposed on any company from 8 October 2021 and until the earlier of 31 December 2023 or the coming into force of the MLC'.

2.2 MEASURES ADOPTED BY COUNTRIES AND INTERNATIONAL AND REGIONAL ORGANIZATIONS

Whilst taxation of the digital economy has been debated for over two decades, actual measures by countries seeking to tax the digital economy have materialized only in recent years. Early country responses often sought to address low tax compliance rates with individuals or businesses operating in the gig or sharing economy, through reporting and other transparency mechanisms. These measures sought to ensure taxation of the resident taxpayers transacting through digital platforms, rather than the digital platforms themselves. However, policy measures quickly broadened to target specific digital platforms, or business models, by expanding direct tax mechanisms. These measures have often sought, at least in part, to plug pre-existing gaps in the international tax framework, such as treaty definitions with respect to PE rules or other source rules. Other measures have been broader in scope and have created novel ways of taxing digital business models. A summary of the most common income tax measures is provided below, and brief descriptions of existing or proposed country regimes are contained in Annex 1. This paper focuses, in particular, on DST rules.

In 2014, Hungary introduced an advertising tax on the net sales revenue for the sale of advertising time or space, by either resident or non-resident firms. The tax was broad in scope, covering traditional media, outdoor displays, and online advertising. In the case of online advertising, the display of advertisements in the Hungarian language was deemed sufficient to create a nexus for the payment of the tax in Hungary. In 2017, the authorities raised the rate of the advertising tax from 5.3% to 7.5% while maintaining the 0% rate on the first HUF 100m. Despite measures to collect tax from the local advertiser in lieu of the non-resident, the authorities have reported low compliance rates among non-resident suppliers, and therefore only limited tax revenues.[36]

In April 2016, the tax administration of Israel issued a draft circular clarifying its position in relation to PE and VAT issues insofar as they apply to foreign suppliers of digital goods and services to Israeli residents.[37] In circumstances where the non-resident has some physical presence in Israel, or if that non-resident has a significant digital presence, it limits the extent to which exemptions for certain ‘preparatory or auxiliary services’ can be used. It further notes that a business may be deemed to have such a significant digital presence where, for instance, it has a significant number of contracts signed with Israeli residents via the internet, where services offered are used by many Israeli residents online, or where internet services are customized for Israeli users. The attribution of profits to the Israeli PE relies on the arm’s-length principle.

France also acted early, in 2016, by extending its excise tax on audiovisual content provided to final consumers for free but monetized through the display of online advertisements to viewers and in 2019 passed legislation introducing its version of the Digital Services Tax. This would capture the revenues of video-sharing services like YouTube and those with similar business models. The tax functions in a similar manner to the 2003 and 2004 measures that applied to videograms (e.g. VHS, DVD) and paid online video-on-demand content, except that the tax base consists of the consideration paid for the display of advertisements or sponsorships linked to a particular online audio-visual content.

In March 2018, the EU Commission published a proposal that, if implemented, would see a 3% tax introduced on certain digital services.[38] The tax would be levied on the gross revenues from certain digital activities. Specifically, the tax would apply to revenues from selling online advertising space (including the transmission of data) and intermediary activities that allow users to interact and sell goods and services. These activities were considered to rely heavily on user participation, a common feature of highly digitalized business not present in traditional business models, to drive value. User participation, it was said, drove value in these activities by virtue of data collection and network effects. The EU Proposal was intended to be an interim tax, pending longer-term reform. The Commission estimated that a 3% tax could raise €5 billion a year. Ultimately, it did not command support from all member states, and was at least temporarily shelved by the Commission. However, the EU’s 2020 budget agreement called for a new digital levy as a funding mechanism and the commission opened a consultation on the levy in January 2021.[39]

36 OECD, Tax Challenges Arising from Digitalisation - Interim Report 2018, p145.
37 Deloitte, World Tax Advisor, 24 June 2016: http://newsletters.usdbriefs.com/2016/Tax/WTA/160624_2.pdf
38 EU Commission, “Proposal for a council directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services”, 2018.
39 https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12836-Digital-Levy

Summary of Measures that Tax Income Derived from Digital Services[40]

1. WITHHOLDING TAXES ON DIGITAL SERVICES

These measures impose a tax on, and act as a collection mechanism for, payments made by residents to non-residents in respect of digital services. The rules create a source taxation right over certain digital services (or recognize an existing taxation right) and could potentially be supported by treaties where source withholding taxation on services income is permitted, although, with limited exceptions[41], neither the OECD nor the UN model tax conventions currently allow for this approach. In April 2021, the UN finalized a new Article 12B to its Model Tax Convention, covering treaty taxation rights over income from automated digital services[42].

Withholding taxes—which are already commonplace for royalty, interest, and dividend payments—can be especially effective for the taxation of non-residents with no physical presence in a jurisdiction, although the practicalities of withholding an amount in respect of tax, and then remitting it to the tax administration, mean this mechanism is better suited to payments made by businesses rather than by consumers.

Generally, tax would be assessed by applying a withholding tax rate on the gross payments made for digital services. All businesses receiving payments for the digital services are potentially in scope, however the rules are usually limited to a specific subset of digital services.

2. 'VIRTUAL' PEs

These measures give jurisdictions the right to tax non-resident businesses that have a sustained economic interaction with their economies. This 'nexus' approach can apply even if the business has no physical presence in that jurisdiction. A taxable presence is deemed if, for example, the business has a sufficient level of sales or user engagement in the jurisdiction.

Once a virtual PE is triggered, a portion of the profit of the non-resident business could be attributed to that jurisdiction. There are considerable uncertainties about how profit is to be allocated to the 'nexus' and, in cases where a PE is deemed, how existing attribution principles apply.[43]

3. DST RULES

These measures seek to directly tax businesses earning income from certain digital services, such as online advertising and intermediary services. In many of the DSTs currently adopted, taxable revenue is measured by apportioning the global in-scope revenues of a digital business by reference to, for example, the number of advertising views or the number of transactions conducted by the country's residents as a share of global views or transactions. Other DSTs seek to tax the income earned by digital service providers by reference to fees directly or indirectly paid by users in their jurisdiction. In contrast to withholding taxes, DST rules do not necessarily rely on revenue being withheld by customers in the taxing jurisdiction.

DSTs generally apply a tax on gross revenue derived from the jurisdiction, either directly or indirectly, by the digital services provider. Many digital businesses could potentially be in scope, but most regimes have focused on online advertising services, sale of data and intermediary services. The compliance obligation generally falls on the service provider.

Following the shelving of the EU DST Proposal, in 2019 France passed legislation introducing its version of the Digital Services Tax. The structure aligns with the EU proposal above, imposing a 3% levy on revenues from online advertising (including the sale or license of data) and intermediary services. Broadly, such revenues are attributed to France based on the location of the user at the time the advertisement is viewed or at the time the transaction takes place. The rules apply to digital businesses with global in-scope revenues exceeding €750 million, of which €25 million or more is generated in France.

40 This section and, more broadly, this paper focus on tax measures that have been adopted or are under development at the country, regional (ATAF and EU), and international (OECD and UN) level. It does not include a commentary on all proposals regarding taxation of the digital economy, though there are many valuable contributions. For example, the World Bank's Cristian Oliver Lucas-Mas & Raul Felix Junquera-Varela have authored a book which proposes a different and possible complementary solution: a 'digital data tax', to be administered globally; Lucas-Mas, Cristian Oliver; Junquera-Varela, Raul Felix. 2021. Tax Theory Applied to the Digital Economy : A Proposal for a Digital Data Tax and a Global Internet Tax Agency.

41 Article 12A of the UN Model may create source taxing rights over payments for some digital services and this is discussed in more detail later in this paper.

42 https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-08/TAX%20TREATY%20PROVISION%20ON%20PAYMENTS%20FOR%20DIGITAL%20SERVICES.pdf

43 Largely embodied in the "Report on the attribution of profits to permanent establishments", OECD, July 2010.

Uruguay introduced a DST in January 2018, building on earlier initiatives to tax ride-sharing activities in the country.[44] The rules apply to the provision of online content and certain intermediation services. Platforms are subject to the normal non-resident income tax rate at 12%. Income from the provision of online content to a user in Uruguay is considered entirely Uruguay sourced. Income from intermediation services is also considered as entirely Uruguay sourced if both the supplier and the user are located in Uruguay, but 50% of the income is allocated to Uruguay if either the supplier or the user is located outside Uruguay. Uruguay's DST, however, does not apply to online advertising services or revenues associated with the collection or transmission of data.

The Chilean government proposed a 10% DST as part of the tax reform bill introduced in August 2018. Their DST was narrow in scope, applying only to digital services provided to individuals (such as on online marketplaces and the provision of digital content). The source was based on the place of payment origination, and to assist with compliance burdens, it was proposed that a withholding tax obligation would be placed on Chilean banks and credit card companies. The DST proposal was abandoned in 2019 and replaced with a proposal for a 19% VAT on certain digital services. Under these rules a digital service is deemed to be taxable if two of the following criteria indicate that the user is located in Chile:

- The IP address of the device used;
- The registered address associated with the bank card or payment method;
- The user's stated address for invoicing purposes; and
- The registered jurisdiction of the SIM card (in the case a mobile phone is used).

Several other countries have explored taxation of digital services through withholding taxes. In 2018, **Malaysia's** Inland Revenue Board issued a practice note that requires Malaysian residents to withhold on digital advertising fees paid to non-residents, generally at 10%. In the same year **Pakistan** introduced a 5% WHT on payments for a broad range of digital services provided by non-residents. In this case, the obligation largely falls on banking and financial institutions that are required to remit the 5% on behalf of Pakistan residents. Several other countries, including **Taiwan, Thailand, Costa Rica, Mexico,** and **Vietnam** have implemented similar rules, requiring local taxpayers (or financial institutions) to withhold on behalf of the non-resident digital services provider. Effective December 2020, **Argentina** imposed withholding tax, starting at 5%, on bets made in or from Argentina through a digital platform. As these rules are a mechanism for collecting income tax on local source income of non-residents, these rules can be overridden by double tax treaties, which, depending on their wording, may reduce or entirely eliminate the withholding tax.

In October 2018, the UK Government announced that it would introduce a DST, following the publication in March 2018 of a position paper. The DST was ultimately introduced in April 2020. This decision reflected uncertainty about the outcome of the discussions on possible reforms to the global tax system and a determination to tax digital businesses on the value they derive from their UK users. The UK rules[45] differ significantly from many other European approaches by focusing on the nature of the business model rather than the nature of the digital services. The UK's DST, set at 2%, applies to search engines, social media platforms and online marketplaces where revenues are linked to the participation of UK users. In contrast to the other European approaches, online advertising revenue derived by these platforms would be attributed based on the intended audience, rather than the location or number of actual views. The UK rules also encompass a specific rule for online marketplace transactions involving real property (such as accommodation and hotel rentals), whereby attribution is based on the underlying location of the property (rather than the location of the users). Generally, where a UK user is one of the participants of an online marketplace, all the revenues from the covered transaction will be within the scope of the DST. This is reduced to 50% where one of the participants is normally located in a country operating a similar DST. There are several other unique features in the UK rules, including an alternative basis of charge and a specific anti-avoidance rule[46]. The UK estimates the DST will raise £280m in 2020/21, rising to £515m by 2024/25.

In 2019, several other European countries announced plans to implement DSTs. Italy's DST, effective from January 1, 2020, closely follows France's approach. In October 2019, **Austria** passed legislation introducing its own DST. However, Austria's rules are narrower in scope, applying only to online advertising and not to intermediary services. Austria's DST also applies a higher tax rate of 5%. In October 2020, **Spain**'s DST was enacted, with effect from January 1, 2021. Spain's DST closely followed the EU proposal and, like France, relies on the location of the user at the time the advertisement is

44 See PWC, Tax Insights, June 2018: https://www.pwc.com/us/en/tax-services/publications/insights/assets/pwc-uruguay-tax-affects-digital-services.pdf and EY, Global Tax Alert, September 2018: https://www.ey.com/en_tw/tax/tax-alert/uruguay-executive-power-issues-regulations-on-taxation-of-foreign-entities-income-from-services-rendered-by-electronic-means

45 https://www.gov.uk/hmrc-internal-manuals/digital-services-tax

46 Further details of the UK approach can be found at https://www.gov.uk/government/publications/introduction-of-the-digital-services-tax/digital-services-tax

viewed or at the time the transaction takes place. **Turkey's** DST was implemented from March 1, 2020 and, although similar in scope, has a tax rate of 7.5%.

Kenya expanded its general income tax rules in November 2019 to include income accruing through a digital marketplace (i.e., a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means). Kenya's 2020 Finance Act[47] went a step further, proposing a 1.5% digital services tax, payable on revenue which is deemed to be derived or accrued in Kenya through a digital marketplace. Income Tax (Digital Service Tax) Regulations were issued in December 2020,[48] which came into force on January 1, 2021. These apply Kenya's DST to gross income derived from a broad range of digitally provided services to users in Kenya. These include fees for downloading or streaming digital content and those charged for the provision of digital marketplace services. They also include income derived from monetizing data "about Kenyan users generated from the users' activities on a digital marketplace". Kenya, an Inclusive Framework member, did not register agreement with the Inclusive Framework's July 2021 statement.

In February 2020, Nigeria expanded its source rules to effectively include a nexus based on a "significant economic presence" test. Services provided by non-residents, including those transmitted digitally, as well as the provision of online content, are taxable to the extent they are attributable to the significant economic presence in Nigeria. Under an order[49] issued by the Ministry of Finance, Budget and National Planning, significant economic presence is, broadly, defined to include businesses:

- With a turnover of N25m or more from digital services provided to users in Nigeria or taxable goods or services that are delivered either directly or indirectly through digital channels to Nigeria.
- With a Nigerian website or domain name
- Having sustained interactions with Nigerians by customizing its digital page or platform to Nigerians.

Nigeria, an Inclusive Framework member, also did not register agreement with the Inclusive Framework's July 2021 statement.

Zimbabwe also introduced rules to tax non-resident digital service providers at 5%. The tax, enacted in February 2020, covers the provision of e-commerce and satellite services to local residents and is triggered if the non-resident's sales to Zimbabwean customers exceed USD 500,000. **In Argentina, two provinces announced the expansion of existing turnover taxes to cover certain digital services.[50]** The tax, which applies from January 1, 2021 is levied at 2% for service providers not located in Argentina.

Indonesia included measures that impose direct taxation on the digital economy, as part of a package of fiscal responses to the COVID-19 crisis announced in government regulations issued in March 2020.[51] This is an interim measure, pending international agreement on direct taxation of the digital economy and is not yet in force. Tax will be imposed when a digital business has a "significant economic presence" in Indonesia. The definition of significant economic presence is based on thresholds of global turnover, local sales, and numbers of local users. Businesses that meet the threshold will be deemed to have a PE in Indonesia, subject to income tax. Where there is a double taxation agreement in place that overrides the ability to tax such a deemed PE, an "Electronic Transaction Tax" would apply instead.

In May 2020, a proposed digital services tax was submitted to the House of Representatives in Brazil. The proposal, similar in structure to the EU proposal, would cover services in relation to online advertising as well as digital platforms that permit users to interact with the objective of the sale of goods or services directly between such users if one user is located in Brazil. The DST is proposed to be progressive, with a rate of 1% for amounts up to R150m, 3% on amounts up to R300m and 5% on amounts exceeding R300m.

In August 2020, the UN Committee of Experts on International Cooperation in Tax Matters issued a draft new Article (and associated commentary) to the UN Model Conventions (draft Article 12B) which would allow a jurisdiction to tax, on a gross basis, income from certain digital services paid to a resident of the other Contracting State. The Article is targeted at income from automated digital services, which are defined as payments for services provided on the internet or 'an electronic network requiring minimal human involvement from the service provider'.

47 http://kenyalaw.org/kl/fileadmin/pdfdownloads/Acts/2020/TheFinanceAct_No.8of2020.pdf
48 https://www2.deloitte.com/content/dam/Deloitte/ke/Documents/tax/The%20Income%20Tax%20Digital%20Service%20Tax%20Regulations.pdf
49 Companies Income Tax (Significant Economic Presence) Order 2020, https://pwcnigeria.typepad.com/files/companies-income-tax-significant-economic-presence-order-2020.pdf
50 EY, Digital services tax Jurisdiction activity summar, December 2020
51 Government Regulation in lieu of law (Perppu) Number 1 of 2020.

The draft Article 12B allows for source-taxation in relation to payments for automatic digital services, which is the 'direct approach' described in this paper. Other than if a PE is involved, the draft allocates taxing rights to the country of the residence of the payer. The draft also provides an alternative basis of taxation that is available at the taxpayer's request. This substitutes taxation of the gross income with taxation of a share (30%) of the net profits derived from digitally provided services, calculated by applying the profitability ratio of the MNE group as whole, or that of the relevant segment, if appropriate, to the gross income derived from the contracting state.[52] Under this alternative basis, any such profit share would be subject to the normal domestic corporate income tax.

In September 2020, the African Tax Administration Forum (ATAF) published a Suggested Approach to Drafting Digital Services Tax Legislation[53] to provide guidance to members that are considering the implementation of a DST. The approach taken by this suggested legislation introduces a DST on 'digital service revenues' derived from, or attributable to a country. ATAF's suggested approach principally applies the 'direct approach' in determining digital service revenues attributed to a particular country. That is, it seeks to tax digital services revenue derived directly from residents of a country. However, the basis of attribution of revenue to a country would vary according to the type of digital service provided. For example, digital services revenue derived from accommodation booking intermediary services would be attributable to the country in which the accommodation is situated. A similar approach is taken for digital intermediary service providers in respect of 'private vehicle hire services', in which case, digital services revenue is attributed to the country in which a journey starts. The suggested approach also allows revenue derived from advertising or the sale of data to be attributed by means of a formula based on the proportion of total users in a country,[54] to the extent that the resultant taxable revenue exceeds that from applying a direct approach (which allocates revenue to the location of the payer).

In April 2021, the Canadian budget proposed a 3% DST, intended to apply from 1 January 2022. The tax, levied on large businesses, would apply to revenue streams from online marketplace, social media, online advertising and user data.

It is also notable that in 2016 India introduced a 6% 'equalization levy', on specified digital services (essentially online advertising). In March 2020, after an industry-wide consultation, India expanded the scope of the equalization levy to include consideration received by e-commerce operators from digital supplies and services, taxed at a rate of 2%. Broadly, the levy covers the sale of goods, provision of services and/or the facilitation thereof (for example, through a platform) by an e-commerce operator. This means that platforms and intermediaries will be liable to pay the levy on the full value of the purchases of goods and services they facilitate, rather than just the commission or fee they charge to users for direct or intermediary services. In contrast to the 2016 levy, it is payable directly by affected operators, rather than through a withholding mechanism. This levy has been in effect since April 2020.[55] The levy has very few features in common with DSTs and similar measures which seek to tax the income derived from digital services. For these reasons, India's equalization levy has more features in common with a tariff, than a tax on income (or a DST).

52 This means, for example, that if an MNE earned $100m fees from digital services arising in Country X, and on a consolidated (or segmented) basis, its net profit ratio is 5%, then the Country X taxing right would be on income of $100m x 5% x 30% = 1.5m.

53 https://events.ataftax.org/index.php?page=documents&func=view&document_id=79

54 For advertising, a user is defined as a viewer of the online advertisement.

55 Further changes to the rules have been included in the 2021 budget and will have retrospective effect from April 2020. Fees for technical services and royalties that are separately taxable under the Income Tax Act are outside the scope of the levy. Fees for online advertising within the scope of the 2016 measure are still subject to the same 6% levy and related requirements.

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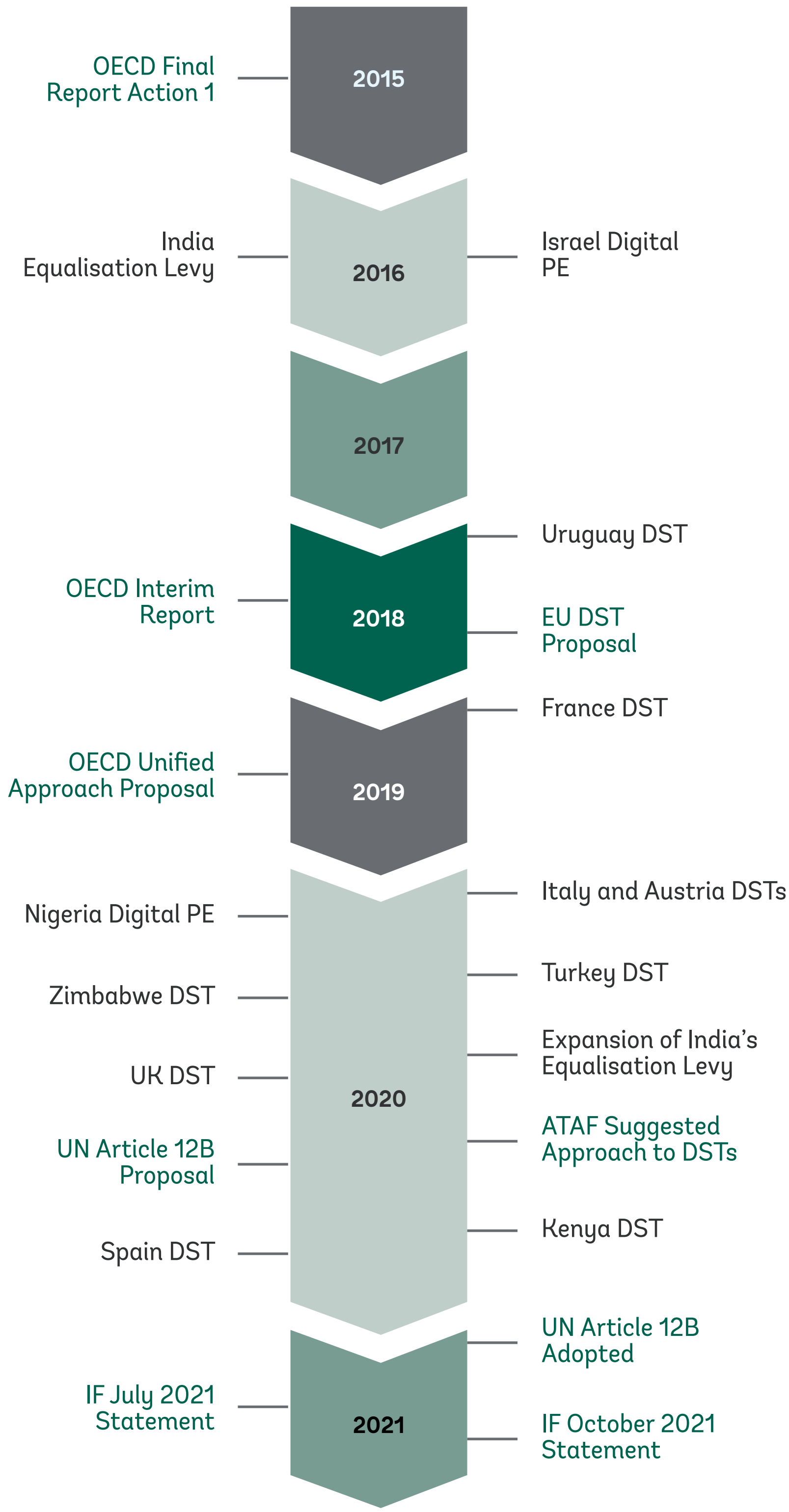
FIGURE 1: Timeline of Selected Tax Measures[56]



56 Country DST dates are representative of effective dates, not dates the legislation was announced or passed.

3.

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Rationale for Adopting a Digital Services Tax

Digitalization allows non-resident multinational enterprises to conduct significant economic activity in a tax jurisdiction with no resulting liability to taxation of any part of the profit they earn. This is of significant concern to many countries and the overriding factor influencing the decision to introduce, or consider introducing, a DST. This section discusses existing principles for the taxation of non-resident enterprises, with a particular emphasis on the taxation of services.

3.1 EXISTING RIGHTS TO TAX THE PROFIT OR INCOME OF A NON-RESIDENT PERSON

In the typical scenario in which a non-resident provider of digital services has no or limited physical presence in a country, existing international taxation principles would rarely preserve that country's right to tax any income or profit earned by the non-resident. This is, of course, the crux of the matter – how to deal with scenarios in which the non- resident conducts significant commercial activity in a country, but has no, or limited, physical presence: 'scale without mass'.

The powers of a tax jurisdiction to tax the income or profit of a non-resident person are established through the interaction of domestic law and tax treaties. The fundamental basis of a right to tax such income is in domestic law, which is paramount if no treaty exists. Where a treaty is in place, however, its terms may limit the taxing rights of the parties to the treaty. Treaties, of course, vary, but the vast majority are based, at least to some extent, on the OECD and UN Model Tax Conventions. In this way, those treaties, and the commentaries on them, form the existing international tax framework. They, in turn, are based on country practice, and most countries fully or partly align their domestic law with treaty concepts, such as the PE definition.

Most treaties, as well as domestic law, do not allow a country to tax the business profits of a non-resident unless that non-resident carries on its business through a PE. Broadly, this will be the case if the non-resident's presence in the country meets certain threshold conditions, the most important of which are that the non-resident conducts its business through a 'fixed place', or by means of a 'dependent agent', in the country.[57] In many cases, as we have seen, the cross-border delivery of digital services can be achieved without either a physical presence or an agent in the country. In such cases, a PE will generally not exist.

57 Some treaties, and domestic law, include broader criteria for the presence of a PE, such as a 'service PE'.

Even where a fixed place or an agent does exist, however, PE status may be avoided if their activities are limited to those defined as 'preparatory or auxiliary'. Such exemptions may reduce taxing rights to below those looked for by some countries[58], but this type of exemption is likely to have only marginal impact on the right to tax profits derived from digital services in most cases. Action 7 of the G20/OECD BEPS initiative introduced a number of changes to the OECD Model Convention intended to narrow the scope of these exemptions. These were in part intended to address the taxation of the digital economy which may involve significant value-adding local warehousing and logistics activity. These changes, while valuable, are limited in scope and do not impact on the fundamental principles underlying the taxation of non-residents. They are likely to have limited impact on the taxation of digital transactions.

In cases where a non-resident person creates a PE, and therefore a right to tax associated profit, that right will be limited to the profit that can be attributed to the PE. This amount is also governed by treaties and domestic law, with the latter often in practice aligned to the former. Where a PE exists, profit attribution rules in domestic law and treaties will normally capture only the profits generated by the activities conducted through that PE.[59] The profit generated by the direct provision to local users of cross-border digitally delivered services, however, are unlikely to be attributable to a local PE under existing principles.

Aside from PEs, most countries also tax certain income payable to non-residents arising from specified sources in their territory. Countries frequently tax non-residents on interest, royalties, or dividend income, and many also tax income arising from the provision of services (discussed below). These taxing rights are grounded in domestic law, but also governed by tax treaties. The taxes are normally collected by means of 'withholding' mechanisms, applied to gross revenue, whereby the payer withholds a certain percentage of the payment, and remits this to the domestic tax administration. Tax treaties specify the rate of withholding tax that a country may impose on payments going to residents of its treaty partner, overriding the rate set in domestic law and, in some cases, reducing it to zero. Generally, the recipient will be able to offset any tax withheld against its domestic tax liability on that income.

3.2 CROSS-BORDER PROVISION OF SERVICES

It is useful to consider how current international taxation principles apply to digital transactions equivalent to the provision of services. Many aspects of the digital economy represent the provision of services to users of digital platforms, or to others. For example, a digital platform may match:

- a driver of private hire vehicle with a passenger
- or the provider of hotel or other accommodation with customers
- or a provider of transport with passengers
- or a seller of a good with a buyer.

In each of these cases, it is cogent to characterize the transaction as a service provided by the digital platform to businesses (such as advertisers, or the owner of a hotel or other accommodation) as well as to individuals (for example, selling goods through a digital marketplace) and, in some cases, consumers. In all cases, the digital business is likely to collect fees from the advertiser, sellers, providers of transport or accommodation, and, in some cases, customers.[60] There is a strong argument that these represent fees charged for the provision of a service. We have seen, however, that current international tax principles, which generally rely on a physical presence in a country, are not well placed to tax the profits arising from the provision of digitally provided services in the countries in which the users of those services are located.

The UN Model Double Taxation Convention has, since 1980, included a provision for a 'services permanent establishment'. The relevant paragraph is reproduced in the box below. This Article would create a PE of a non-resident in a country on the basis of the provision of services by the non-resident within that country for a specified minimum period of time. This would allow the country to tax the net profit of a non-resident arising from the provision of services within that country, even if there is no traditional PE in place. In 2008, the OECD added a provision for an optional equivalent treaty provision in the commentary to Article 5 of its Model Tax Convention.

58 For example, to counter this, Israel limits the application of the 'preparatory and auxiliary' exclusions where the non-resident has a significant digital presence.

59 However, a force of attraction principle in domestic law and/or treaties may create or preserve a right to tax, by virtue of an existing PE, income of the non-resident that is not directly attributable to the activities of the PE. This could potentially include income from digital services provided by the non-resident. A limited force of attraction rule is included in Article 7(1) of the UN Model Tax Convention.

60 In most cases, these fees constitute the tax base of a DST, which may be taxable in a country directly (for example on the basis of the amount of fees paid by users located, or residents of the country, or indirectly (by means of an allocation of the globally received fees according to one or more allocation criteria).

Article 5, Paragraph 3. UN Model Double Taxation Convention

> The term "permanent establishment" also encompasses:
>
> (b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned.

A provision such as this in domestic law, together with a treaty where one exists, is unlikely to create a taxing right over the profits of a non-resident conducting business in the jurisdiction through digital means alone. It is far from clear that automated digital services are delivered through 'employees or other personnel' and the digital provision of such services may not constitute the furnishing of services 'within' a contracting state.

The OECD's traditional view on this, summarized in the box below, is clear.[61] For the OECD, services performed by a non-resident person with no physical presence in a country should be treated in the same way as the domestic consumption of an imported good.

OECD Model Tax Convention on Income and on Capital (2017) Commentary on article 5, paragraph 139

> It should be noted, however, that all member States agree that the State should not have source taxation rights on income derived from the provision of services performed by a non-resident outside of that State. Under tax conventions, the profits from the sale of goods that are merely imported by a resident of a country and are neither produced nor distributed through a permanent establishment in that country are not taxable therein and the same principle should apply in the case of services.

In 2017 the UN added a new Article to its Model Tax Convention, designed to increase taxation rights over technical services provided by a non-resident. Article 12A is designed to give source countries the right to tax fees paid for technical services, described as services of a 'managerial, technical or consultancy' nature. Significantly, the taxing right is not contingent on a physical presence. The adoption of this Article was partly aimed at addressing challenges created by the digital economy. (See excerpt from the commentary on this article in the box below). The scope of this article is targeted, however, at payments for technical services by businesses, with payments made by an 'individual for services for the personal use of an individual' outside the scope, meaning that the Article is unlikely to cover all of the services with which we are concerned here.

Commentary on Article 12 A UN Model Tax Convention (2017), excerpt from Paragraph 2.

> … with the advancements in means of communication and information technology, an enterprise of one Contracting State can provide substantial services to customers in the other Contracting State and therefore maintain a significant economic presence in that State without having any fixed place of business in that State and without being present in that State for any substantial period. The OECD/G20 Base Erosion and Profit Shifting Project, Action 1: Final Report "Addressing the Tax Challenges of the Digital Economy" (2015) illustrates the difficulties faced by tax policy makers and tax administrations in dealing with the new digital business models made available through the digital economy. The Report did not recommend, for the time being, a withholding tax on digital transactions (which include digital cross border services); nor did it recommend a new nexus for taxation in the form of a significant economic presence test. However, it was recognized that countries were free to include such provisions in their tax treaties, among other additional safeguards against BEPS.

Some countries, including many developing countries, consider that the provision of, or payment for, a service provided by a non-resident person can give rise to a domestic source of taxation, irrespective of whether a PE exists. This can be achieved, either by deeming there to be a PE, or by imposing a withholding tax on the payments as we have seen some countries do. Such provisions deviate from both the OECD and UN approaches to the taxation of PEs because: a) they tax gross income, rather than net profit and b) they are not dependent on a physical presence in the source country.

61 However, the commentary to Article 5 (paragraph 144) also provides an example of a possible services permanent establishment.

A survey of treaties between 1997 and 2013 carried out by the IBFD's Knowledge Centre[62] at the request of the UN included an analysis of provisions in those treaties that address the taxation of services. This survey found:

– a limited number of treaties, in deviation of both the text of the UN and OECD Models, contained provisions in the royalty article allowing for source taxation on profits on a gross basis, if the services are to a greater or lesser degree related to the transfer of knowledge and without requiring a physical presence of the service provider in that source state;

– in a more extensive number of treaties (especially between developing countries, but to a lesser degree between developed and developing countries as well), such source taxation on a gross profits basis and without the requirement of a physical presence or connection to the transfer of knowledge, was included in a separate treaty article[63].

It is arguable that such provisions, and in particular the second type of provision, would be compatible with the taxation of digitally provided services, as envisaged in many of the DST rules already implemented by a number of countries. Such rules in effect create domestic source taxation rights over a non-resident service provider meeting, for example, a minimum level of engagement with domestic purchasers. The IBFD White Paper[64] notes:

'From the perspective of many developing countries, the topic is important as they take the view that new electronic communication technologies reduced the need for a physical presence of the service provider and accordingly new business practices have diminished their possibilities for source taxation. A number of these countries claim a taxing right on the service income only on the basis that the customers are resident in their country and can deduct the payment for the services from their domestic tax base'.

The table 1 summarizes the approaches to the taxation of non-resident service providers discussed in the paragraphs above.

It is significant that existing rules reflect a policy view that provision of services by a non -resident to persons located in a jurisdiction can create a taxable event. Seen from this perspective, DSTs formalize an approach that has at least overlapped with the policy objectives of existing international tax principles, and which in practice has been adopted by a number of countries in the context of the taxation of non-residents providing services. That is, source taxation on a gross income basis, without a requirement for a physical presence. In practice, such taxation has typically been implemented through withholding mechanisms similar to those applied to equivalent taxation rights over interest, royalties, and dividends. A withholding mechanism, however, is neither necessary nor inevitable, and other collection mechanisms are available. Indeed, alternative mechanisms are necessary if a DST applies to payments made by businesses outside a jurisdiction, for example for advertising that targets consumers in the jurisdiction. This is discussed further in Section 5.

Existing international taxation principles relating to the taxation of services should be revisited to properly address the digital economy and, in effect, catch up with countries taking their own courses. Rules that assume a physical presence is necessary to provide services need adapting to the digital economy, and clarity is needed on the definition of a service in the digital context (the term 'services' is not defined in the OECD or UN Model Tax Conventions, although the UN Model provides examples of 'technical services' and, recently, 'automated digital services'). The rules governing where a service is rendered, exercised, or delivered need revisiting, given that, under existing rules, it may be that some, if not most, digital services are not 'rendered' or 'exercised' or 'delivered' anywhere.

The work of the UN to introduce a new Article into its Model Tax Convention (Article 12B, discussed above) represents an important step towards adapting existing international taxation principles to meet the realities of the digital economy.

62 The UN Model in Practice 1997–2013, https://www.un.org/esa/ffd/wp-content/uploads/2014/11/9STM_FinalPublishedVersionIBFD.pdf. IBFD, 2014.
63 The Treatment of Services in Tax Treaties https://www.ibfd.org/sites/ibfd.org/files/content/pdf/White%20Paper_Treatment_of_Services_in_Tax_Treaties_v050312.pdf. IBFD White Paper. IBFD February 2013.
64 IBFD, February 2013

> > >

TABLE 1: Approaches to the taxation of non-resident service providers

ROUTES TO TAXATION OF NON-RESIDENT SERVICE PROVIDERS MECHANISM	FOUND IN …	SCOPING CRITERIA	TAX APPLIED TO…
Fixed place or agency PE	Domestic law Bilateral treaties OECD MTC Article 5UN MTC Article 5	Requires a fixed place or agency presence, normally over a minimum period of time.	Profit attributable to the PE (See Article 7 of OECD and UN MTC).
Service PE	Domestic law Bilateral treaties UN MTC Article 5 3. (b) (And option discussed in Commentary to OECD MTC Article 5)	Requires a physical presence over a minimum period of time, but fixed place or dependent agency not necessarily required.	Profit attributable to the PE. (See Article 7 of OECD and UN MTC).
Fees for technical services	Domestic law Bilateral treaties UN MTC Article 12 (A)	No physical presence required in source jurisdiction. Applies to a fee paid by a resident business, or paid by and attributable to, a PE of a non-resident, to a non-resident service provider for technical services of a managerial, technical or consultancy nature.	Gross fee payable, generally collected through a withholding tax mechanism.
Source taxation, deeming the provision of a service, or a payment for a service, as creating a domestic taxable source.	Domestic law Bilateral treaties	No physical presence required in source jurisdiction. In some cases, a source is created if the service is linked to the transfer of knowledge. (Akin to the transfer of IP). In other cases, there is no link to the transfer of knowledge.	Gross payments generally collected through a withholding tax mechanism.
Digital Services Taxation on revenue receivable by a digital service provider.	Domestic law Article 12B of the UN Model Convention	No physical presence required. Normally contingent on a de minimis provision. Applies to revenue receivable by a digital service provider from users/customers in a jurisdiction, or to total such revenue apportioned to, and deemed to arise in, a jurisdiction.	Gross revenue receivable by, or apportioned to, digital service providers, taxed directly.[65] In relatively few cases, a withholding mechanism applies.
Digital Services Taxation – deemed nexus or PE	Domestic law	No physical presence required. Applies to profit attributable to a nexus or a deemed PE, triggered by the volume or value of engagement of a digital platform with a market.	Profit attributable to the PE/ nexus.

3.3 THE PRINCIPLES UNDERPINNING THE TAXATION OF THE INCOME OR PROFIT ARISING FROM CROSS-BORDER DIGITAL SERVICES

The theoretical underpinning of digital services taxation is complex. Some countries have argued that a threshold amount of sales, or number of consumers, in a country creates a source taxing right (that is, a right in the country in which the sales are made), no matter the extent of physical presence of the non-resident. This is sometimes described as creating a 'nexus' or 'digital nexus' or 'significant economic presence', which would create a taxing right akin to that created by a PE. The justification for this has been linked to the notion that

65 A simplified option for taxation on a net income basis is also available in some instances – for example, the UN's Article 12B and the UK DST.

domestic users can themselves create value to the digital provider – perhaps through adding valuable content into a website, or by contributing (knowingly or unknowingly) to valuable consumer or market data. Such considerations could apply to certain types of digital services (such as advertising), but not to all.

The concept of 'nexus'[66] may aim to recognize that information concerning the residents of a country itself creates a source of local value. This view is discussed in IMF (2019)[67], which considers the view that taxation related to digital business models may be rationalized as 'targeted to particular sources of location specific rents.' This view characterizes value derived from information about a country's residents as a source of taxation where they are located, analogous to rents associated with natural resources. In some contexts, similar arguments have been made that the volume of purchasing power created by consumers in a local market itself creates a source of location specific value.[68]

The creation of a nexus does, of course, raise a question of how much income or profit should be attributed to, and taxed in, the nexus jurisdiction. In defining the profit attributable to the nexus, it is important to recognize that the value referable to a specific market is not only realized through payments from that market. For example, a vendor in country A pays a platform in country B for data derived from platform users in Country C. One way to capture revenue referable to the users' market in a country more broadly would be to tax profit attributable to the 'nexus', in a way akin to the attribution of profit to a PE. However, it is difficult to see how existing principles for profit attribution could be adapted to a nexus created by mass alone. Such an approach is likely to be complex and could create significant uncertainties.

Another issue arising from the 'nexus' approach is that it may be strongly grounded in sales. In such cases, the nexus – and therefore a taxing right – is highly dependent on the volume of sales in a jurisdiction. While this may be appropriate in some circumstances, it risks ignoring that significant economic activity may be carried out in jurisdictions in which there are few, or even no, sales. For example, a hotel booking platform may make a large proportion of its sales to customers in relatively developed economies in circumstances where the underlying hotel accommodation is situated in developing economies. Is it appropriate that the right to tax income or profit arising from such transactions lies only, or primarily, with the jurisdiction on which the consumer sales are made? Even if the answer to that question is no, and an element of profit is attributed to the nexus on the same basis as the income from advertising discussed in the previous paragraph, it is still difficult to see how existing principles of profit attribution would operate.

An alternative approach to grounding a DST in existing principles may be to link a DST to existing domestic source taxation rights, akin to those already widespread for interest, royalties and, in many cases more realistically, services. This would be a relatively simple model, under which the income arising from domestic activity would be subject to a withholding tax. The withholding tax model is limited in its impact because it can only apply to payments originating within the source country, and there are practical challenges in enforcing withholding taxes on payments made by consumers. At the level of principle, it is difficult to see how payments for digital services are routinely linkable to interest or royalties, but, as discussed above, there is a plausible argument that such payments could be characterized as payments for services, or technical services, which, as we have seen, create a domestic taxing right in some countries, and under the provisions of some treaties. A platform for peer-to-peer sales, for example, may be characterized as providing services to the seller, or, perhaps to a lesser extent, the buyer. The practical issues arising from a withholding tax mechanism suggest that a more realistic approach is for countries to tax a non-resident service provider directly on the income receivable from the provision of digital services to domestic customers, whether consumers or businesses. This approach has been taken by many countries in their DST and adopted in the new Article 12B approved for inclusion in the 2021 UN Model Tax Convention.

In some instances, there is an argument that a DST may take the place of customs duties in respect of the sale of a digital good which, which may have been due had it been delivered in physical form (such as on a disk)[69]. Since 1998 World Trade Organization ('WTO') members have agreed not to impose customs duties on electronic transmissions, which are understood to include software, digital music, movies and videogames. The moratorium has been extended several times since, most recently at the WTO General Council meeting in December 2019[70]. Discussions on this issue are

66 Recently, the concept of 'nexus' has been used broadly to describe the taxing rights, covering both the threshold right to tax and the identification of something to be taxed (e.g., value, income, revenue).

67 IMF Policy Paper: Corporate Taxation in the Global Economy. https://www.imf.org/en/Publications/Policy-Papers/Issues/2019/03/08/Corporate-Taxation-in-the-Global-Economy-46650

68 See for example the discussion on, and definition of, 'significant digital presence', in European Commission Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence. https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_significant_digital_presence_21032018_en.pdf

69 In respect of the cross-border sale of physical goods, DST may also be seen as taking the place of customs duties on imports. It is now commonplace for consumers across the world to purchase goods from online foreign retailers, but customs duties on low-value imported packages are often subject to exemptions.

70 https://www.wto.org/english/news_e/news19_e/gc_10dec19_e.htm.

expected to continue and there are mounting calls from developing economies to end the moratorium.[71]

The considerations above suggests that the policy objectives of a DST may not significantly depart from those of existing international tax principles embodied in the UN Model Taxation Convention but also recognize that those approaches were not designed with the digital economy in mind. In their current form, the approaches are unlikely to be fully effective in taxing income arising to multinational enterprises operating in a country without a physical presence. Even though they may have similar policy objectives and some overlaps (such as the source taxation of services), grounding a DST in existing principles, with the policy baggage and precedents they carry, may create risks of challenges to their application from taxpayers, and perhaps treaty partners. For this reason, some tax administrations have designed and implemented DSTs as a separate standalone tax, intended to be unconnected to existing income tax measures and unaffected by double tax treaties.

Finally, an analysis of existing principles usefully points to areas in which a DST might significantly diverge from existing approaches, as well as identify areas where there is some overlap. It is significant that many DSTs do not seek to create local source income from sales of a platform's own products without physical presence or the carrying out of local functions. This type of activity is traditionally in the realm of taxes on consumption (such as VAT or GST) or customs duties, although, of course, DSTs (which tax income) and taxes on consumption are not mutually exclusive. The application of DSTs to, for example, video streaming, however, raise questions concerning whether such products can be characterized as the sale of a product or a 'service.'

3.4 THE INTERACTION OF DIGITAL SERVICES TAXES WITH TAX TREATIES

An issue arises on the extent to which a stand-alone digital services tax, which seeks to tax all or part of certain revenues arising to online digital platforms, falls within the scope of a tax treaty. The objectives behind DSTs may be significantly undermined if they fall within the scope of, and are therefore subject to, existing treaties which generally limit a country's source taxation rights over in-scope income generated by non-resident service providers.

A number of countries take a clear view that their own DST rules do not fall within a treaty, with the result that the scope and operation of the rules are not subject to any restriction or override contained in a treaty. For example, the UK Government states that its DST is not within the scope of its network of treaties.[72] Its reasoning was set out in the original consultation on the design of the DST. Essentially the argument is that the term "income" cannot be construed to mean gross receipts but rather must refer to the amount that is earned after deduction of relevant costs and expenses.[73]

The fact that current treaties apply to specific items of gross income (such as interest, royalties and technical service fees), however, suggests that the UK position is not uncontroversial and it is possible that a different view may be taken by some countries and courts. Uncertainly about this issue has the potential to lead to disputes, double taxation, and unpredictability of tax treatment. It is clearly important that global fora strive to reach a consensus position on this issue, and, in this respect, the publication by the UN of a draft Article explicitly addressing DSTs is welcome.

71 See e.g. https://unctad.org/news/should-digitally-delivered-products-be-exempted-customs-duties
72 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/754975/Digital_Services_Tax_-_Consultation_Document_FINAL_PDF.pdf, page 32.
73 The OECD and UN Model Tax Conventions apply to taxes on 'income and on capital'. A tax on income is regarded as a tax on total income or elements of income. (Article 2 of the OECD and UN Models).

4.

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Digital Services Taxation: Legislative Approaches

This section describes the approaches jurisdictions have employed in the design of DSTs. In doing so it describes several options available to jurisdictions.

4.1 INCOME TAX OR DIGITAL SERVICE TAX

A key consideration is whether the taxation of digital services is achieved though extending the scope of existing income taxes (including corporate income taxes) or through the introduction of a new and stand-alone tax. Many countries have opted for, or are considering, a new digital services tax. Other countries have extended the scope of existing income tax rules by expanding the PE definition to include digital PEs, imposing withholding taxes on digital services or otherwise expanding source rules. In contrast, the OECD's Pillar 1 of the 'Unified Approach', which extends beyond the digital economy to cover traditional 'consumer facing businesses,' envisages allocating to a country, through a multinational arrangement, an element of total profit attributable to the local market. A summary of country approaches is provided below:

TYPE OF REGIME	
DST	EU Proposal, France, Italy, Spain, Turkey, Austria, UK, Zimbabwe, Kenya, Uruguay, ATAF
Digital PE	Nigeria, Israel, Indonesia
Withholding Tax	Malaysia, Pakistan, Taiwan, Costa Rica, Uruguay (for audio-visual services), Thailand, Vietnam, Mexico, Paraguay
Other	OECD Pillar 1 Proposal
INTERACTION WITH INCOME TAX	
Part of Income Tax Regime	OECD Pillar 1 Proposal, Nigeria, Israel, Uruguay, Zimbabwe, Kenya, Malaysia, Pakistan, Taiwan, Costa Rica, Thailand, Vietnam, Mexico, Paraguay
Separate from Income Tax Regime	EU Proposal, France, Italy, Spain, Turkey, Austria, UK, ATAF

The approach of extending existing income tax rules has the advantage of being able to use existing taxation concepts and mechanisms. However, that same advantage also potentially introduces complications arising from the application of established concepts and principles in domestic law and in tax treaties. For example, the justification for extending the scope of existing income tax rules may rely on concepts such the establishment of a nexus, sometimes deeming a PE or creating new local source taxation rights. The reasoning behind the source taxation of income derived from local digital activity may be grounded in concepts such as value derived from the local market itself or that contributed by local users interacting with a digital platform. Whilst such concepts are plausible, they are often vaguely defined, and their grounding in existing principles is arguable. This has the potential to create uncertainty as well as challenges from taxpayers based on established law or precedent, or from treaty partners.

This issue is especially significant in relation to tax treaties, which generally import established international taxation principles. For example, under most treaties, the right to tax the profits of a non-resident is limited to circumstances in which that non-resident conducts its business through a PE in a jurisdiction. In addition, treaties typically stipulate the principles behind the attribution of profit to a PE. In some treaties, there may be room for flexibility in the interpretation of existing terms (for example in relation to the provision of services by a non-resident person), but in many cases, the terms of existing treaties risk uncertainty and risk challenge. Treaty considerations are discussed in more detail in Section 3.

4.2 THE TAXATION OF PROFIT OR REVENUE

A further variable is whether to seek to apply the tax to a measure of net profit (computed after the deduction of expenses) or to a measure of revenue. Almost all the countries whose DST regimes are described in Annex 1, as well as the ATAF and UN approaches, apply their digital taxes to a measure of gross revenue – for example, the gross revenue arising from the sale of advertising or data, or the amounts collected from users for provision of a service.[74] These measure arguably apply a form of presumptive taxation, where a lower tax rate is applied on gross revenues as an alternative to computation of taxable income.[75] This has similarities with other source taxation mechanisms such as withholding taxes, which apply to the gross value of certain payments arising in source countries (such as dividends, interest, royalties and certain services). The only exceptions to taxing a measure of revenue appear to be Nigeria and Indonesia, where the rules apply to a measure of net profit. Nigeria's rules refer to '*the extent that the company has significant economic presence in Nigeria and profit can be attributable to such activity*'. The OECD's 'Unified Approach' also applies to a measure of profit – in this case, a portion of actual profit earned by an MNE, allocated between countries in accordance with a formula.

The application of a tax to a measure of revenue is likely to be significantly simpler than the application to a measure of profit, especially under any unilateral approach. The attribution of profit to a 'nexus' or deemed or actual PE is likely to be a complicated process, resulting in uncertainty of approach, and high compliance and enforcement costs. And an approach relying on a formulaic apportionment of all or part of global profits is likely to be problematic to implement in rules adopted by a country unilaterally. In particular, there may be significant issues concerning the measure of global profit arising from a specific business stream, and the accessibility to a country of the information required to apportion that measure may be limited.

A further consideration is to determine the tax rate at which the measure of revenue or profit is taxed. Existing DST regimes (which all tax measures of revenue) have tax rates varying from 1.5% to 12%. The generally low rates reflect that DST is applied at the gross level (i.e. on revenues), compared to income tax which is levied at the net level (i.e., on profits). A comparison of the DST rate and the statutory corporate income tax rate in existing DST regimes is shown Figure 2.[76]

4.3 SCOPE OF A DIGITAL SERVICES TAX – CATEGORIES OF TRANSACTIONS

The digital economy encompasses a wide range of digital transactions and business models. The digital economy is a broad concept, comprising a range of business lines, often with commonalities and broad tax compliance risks. Just as there is no commonly agreed definition of what comprises the digital economy, and how it should be measured, neither is there a clear consensus on how to classify or categorize its various segments or economic actors. A description of the main types of transactions encountered in the digital economy, and the income flows typically subject to taxation by DSTs, can be found in Annex 2. Countries introducing a digital services tax can opt to apply that tax to either a full range of such transactions or limit the application to specific categories.

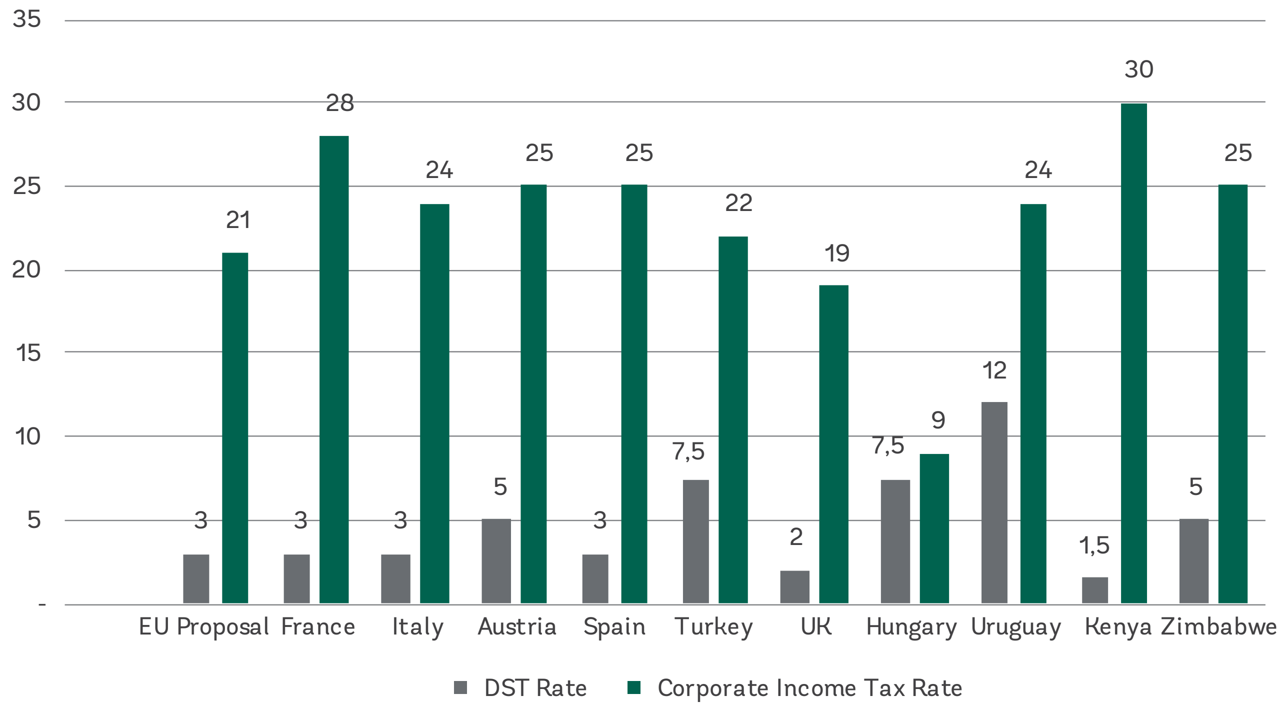
74 Although, the draft Article 12B of the UN Model does provide the taxpayer with an option to be taxed by reference to a share of net profits.

75 There is also commentary that taxation of gross income is justified on the basis that the marginal cost of providing services is often zero. See for example, Cui, Wei, The Digital Services Tax: A Conceptual Defense (April 22, 2019). 73(1) Tax Law Review 69-111 (2019). However, it should also be noted that there may be significant indirect and (average) costs of providing digital services.

76 Corporate Income Tax rates obtained from KPMG corporate tax rates table, accessed at https://home.kpmg/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html. The EU corporate income tax rate is the EU average rate.

> > >

FIGURE 2: DST rates and Statutory corporate income tax rates in existing DST regimes



Transactions potentially in scope include the following:

a) **Income arising from the sale of advertising**. As described in Annex 2, advertising revenue is central to the business model of many digital platforms. The digital service taxes of most countries with existing or planned DSTs (e.g. UK, France etc.) envisage the taxation of such income.

b) **Similarly, income arising from the sale of data and information** derived from digital platforms is also an important source for the operators of many digital platforms.

c) **Income derived from intermediary services online platforms serving to link customers with businesses**. There is a very wide range of such platforms, including those linking customers with providers of accommodation, private vehicles hire and transport. As described in Annex 2, a fee is typically charged to business users (such as hotel owners) and, in some cases, customers. Such fees usually constitute all or part of the income subject to a digital services tax.

d) **Income derived from peer-to-peer digital marketplaces.** These platforms typically connect buyers and sellers of goods and, in some cases, services. In many cases, a fee is charged (or effectively charged) by the platform to the buyer and, in some cases, the seller. In such cases, these fees constitute all or part of the income commonly captured by digital services taxes.

e) **Income derived from the online provision of other services**. These may include, for example, income derived from online gaming and gambling sites, providers of cloud computing services or providers of online digital content. Where fees are charged to users by such sites, those fees constitute all or part of the income subject to digital services taxation.

f) **Income derived from the direct sale of digital content**. The DSTs of relatively few countries seek to tax income received by digital service platforms from the direct sale of digital content (e.g. Zimbabwe, Nigeria, Uruguay, Kenya). This may include, for example, the taxation of income derived from charges for digital content relating to music, movies, videos, e-books, audiobooks, virtual reality, games, applications, digital magazines or publications. From a conceptual point of view, it is arguable that the taxation of such items would extend the scope of digital income taxation to solely sales activity, or consumption, rather than the provision of a service. However, there are elements of some of these platforms that blur the line between sales and service. For example, platforms may provide search facilities, or capabilities for storage and categorization of digital products, or the facility to share comments and feedback with other users, or personalized suggestions. These, and similar auxiliary capabilities, render the distinction between 'sales' and 'services' unclear.

g) **Income derived from the sale of goods.** To date, countries have not sought to tax such sale proceeds under a DST, reflecting that this does not represent the provision of services. Exceptionally, India's equalization levy (which we characterize as a tariff, rather than a tax on income) applies to the sales revenue of goods or services sold through a digital platform, whether on behalf of another person (in the case of intermediary services) or for the account of the owner of the digital platform (or persons related to those operators or owners).

It is important to note that the owner of a digital platform may be subject to taxation on the income derived from more than one of the above categories. For example, an online platform linking customers with providers of accommodation services may derive fees from users as well as income from the sale of data generated from the platform and income from the sale of advertising on the platform. In such cases, the liability for taxation would be based on income derived from the total of those earned under a), b) and c) above.

>>> EXCLUSIONS FROM SCOPE

Some countries have excluded certain categories of digital transactions from the scope of digital services taxation rules. These include financial services, communication services and intra-group transactions (that is, services provided by one member of a group of companies to another member).

A summary of country practice is provided below:

SCOPE INCLUSIONS	
Online Advertising (including the sale/ license of data)	EU Proposal, France, Italy, Spain, Turkey, Austria, UK, Kenya, ATAF
Intermediary Services	Uruguay, Kenya, EU Proposal, France, Italy, Spain, Turkey, UK, Kenya, ATAF
Provision of Online Content / Services	Zimbabwe, Nigeria, Uruguay, ATAF, Kenya, Turkey
Specified Platforms	UK (social media, internet search engine)

SCOPE EXCLUSIONS	
Certain Financial Services	France, UK, Spain, Turkey, Italy, Kenya
Certain Communication Services	France, Turkey, Spain, Italy, EU Proposal
Intra-Group Transactions	Spain, France, Italy, EU Proposal
Online services provided by government institutions	Kenya

4.4. SCOPE OF A DIGITAL SERVICE TAX – SIZE OF TAXPAYER OR VALUE AND VOLUME OF TRANSACTIONS

Bearing in mind the compliance and collection costs associated with a digital services tax, most countries have limited the scope of such taxes to larger multinational taxpayers. All the countries surveyed that have adopted such limitations have introduced an exclusion from the regime by reference to the worldwide turnover or digital services revenue of the group of companies and the total digital services revenue arising in the country.[77]

DST REGIME	GLOBAL DE MINIMIS THRESHOLD (€M)	LOCAL DE MINIMIS THRESHOLD (€M)
EU Proposal	750	50
France	750	25
Italy	750	5.5
Austria	750	25
Spain	750	3
Turkey	750	3
UK	555	30
Hungary	n/a	0.3
Uruguay	n/a	n/a
Kenya	n/a	n/a
Zimbabwe	n/a	0.5

77 For Turkey, the UK, Hungary, Uruguay and Zimbabwe, threshold amounts are denominated in local currency and have been converted to Euros at the time of writing.

4.5 THE DETERMINATION OF INCOME SUBJECT TO DIGITAL SERVICES TAXATION IN A JURISDICTION

Another design element of digital services taxation is to determine the amount of income subject to digital services taxation in a tax jurisdiction. There are two broad approaches.

The first approach ('indirect approach') is to allocate a measure of global revenues between jurisdictions. In such cases, the global revenues arising to platform from a category of income (such as advertising revenue), or from a specific contract, is determined to be allocable to (and taxable in) a specific jurisdiction according to a specified formula. This might be based, in the case of advertising for example, on the location of users or the devices in which the advertising is intended to be viewed. Where such an approach is adopted, it will be necessary also to consider how the location of a user, or a device, is to be determined. This might be based on, for example, the users' IP addresses, or billing address, or residential address. An allocation approach makes sense where the DST seeks to capture value derived from, for example, the scale of interaction with, or the volume of, the market, and may be particularly appropriate to tax income arising from advertising revenue or the sale of market or user data.

The second approach ('direct approach') is to tax fees paid to digital service providers by persons resident of, or located in a jurisdiction (including through PEs). Taking advertising income again as an example, under the direct approach, it would be considered that the income arises in the jurisdiction in which the advertising fees are paid, or the payer is resident. In such a case, the actual fees paid by persons resident of, or located in, a jurisdiction in a period would be taxable in that same jurisdiction. Similarly, the taxable income of a private vehicle hire platform could be based directly on fees payable by domestic drivers and/or customers to that platform. Regimes employing withholding taxes follow this direct approach, although a withholding mechanism is not necessary for the collection of DSTs and may be impracticable in respect of service fees payable by consumers.

These approaches are not mutually exclusive, and the same type of online platform may be subject to both approaches applied to different categories of income. For example, an online marketplace may earn income subject to the indirect approach (in relation to advertising revenues, for example) as well as from the direct approach (in relation to fees collected from users, for example). The combined income would constitute the taxable digital income subject to taxation in a jurisdiction in a tax period. ATAF's suggested approach to drafting DST legislation is an example where both approaches are applied to different types of income.[78]

The two approaches may each be suited to specific types of digital activities. The direct approach makes sense where users pay fees for services provided to them. For example, a holiday accommodation provider (e.g. hotel operator, or apartment owner) may pay fees to an online platform (or have fees withheld) relating to the display/promotion of the accommodation, the linking up with a customer, and the making of a sale. In such cases, it is clear that a 'service' is provided to the accommodation provider. From a practical point of view, it would be reasonable for the operator/owner of the online platform to be required to report to a tax jurisdiction the amount of such fees receivable from accommodation providers in their jurisdiction. Similar considerations apply also to online platforms that facilitate, for example, private vehicle hire or peer-to-peer sales of goods and services.

Under both approaches legislation needs to be specific on how fees will be taxed since it is possible that the users of intermediary services (for example, buyers and sellers) are located in different tax jurisdictions. This is likely to be the case for accommodation and transport booking sites, as well as for peer-to-peer sales, for instance. In such cases, the legislation needs to specify how such fees are to be taxed. Options include:

- in the jurisdiction in which the payer is located. For example, in the case of accommodation booking site, fees may be charged (or effectively charged) to both the accommodation provider and the customer. In such a case, they would be taxable in each jurisdiction according to the amounts paid by each of the users there.
- in the jurisdiction in which the service is effectively provided. This might be, for example, the jurisdiction in which a car-ride is made (or commenced) or the accommodation in question is located. In such as case, all fees would be allocable to those jurisdictions.
- to split the allocation between jurisdictions on a formulaic basis. For example, a country may seek to tax 100% of the fees if both the supplier and the user are located in its jurisdiction, but only 50% if one or the other is

78 The ATAF suggested approach also includes the potential of applying both approaches to the same type of income. In these circumstances, the indirect approach effectively supersedes the direct approach if the indirect approach results in a greater amount of attributable income. Otherwise, the direct approach applies.

outside the country[79]. Another approach is to consider all fees taxable in a user country if the other user is located in a country that does not tax the relevant digital income. For example, the UK's DST generally applies to all the revenues earned from a transaction via an online marketplace where one or both of the parties is a UK user. However, the revenue charged is reduced to 50% when a user is normally located in a country that operates a similar tax to the DST.

The indirect approach is perhaps better suited where the allocation of taxable income is intended to be linked to the volume of country users or engagements with the online platform, rather than the location of the recipient of, say, advertising services. This is a matter of policy. It appears that some countries take the view that the value generated by, for example, online advertisers or from the sale of data, is most appropriately allocated to the jurisdictions in which the advertisements are viewed or those where the users add-value to the platform or those in which information and data pertaining to users is generated. The conceptual justification for such approaches may include a view that the mass and size of the market represents a source from which, for example, user data or information is extracted; or that user interactions create or enhance the value or popularity of the platform and thus its capacity to generate advertising revenue.

Spain, for example, relies on indirect attribution approaches, and has included a specific provision requiring taxpayers to implement systems that ensure they can apply such an approach:

Article 13(1) - Spanish Digital Services Tax

Taxpayers of the tax shall be bound, with the requirements, limits and conditions determined by regulation, to:

i) Establish the systems, mechanisms or agreements that allow determining the location of users' devices in the territory where the tax is applied.

In such cases, countries have sought to tax the revenues derived from advertising and/or from the sale of information, in line with the location of the users that 'generated the income'. This is a matter of policy. Countries in which advertisers are located may prefer the direct approach; others may prefer an indirect approach.

Whether a direct or indirect approach is adopted, consideration of how revenues arise in, or are attributed to, the country must be given consideration. Some countries place emphasis on the location of the device engaging with the digital platform, others on the normal residence of the user and others on the underlying location of the service provided. A summary is provided below:

ATTRIBUTION FOR ADVERTISING SERVICES / DATA	
Location of device at time of user engagement	EU Proposal, France, Italy, Spain, Turkey, Austria, ATAF
Location of intended audience of advertising	UK
Location of advertiser paying for service	ATAF
ATTRIBUTION FOR INTERMEDIARY SERVICES	
Location of device at time transaction is entered	EU Proposal, France, Italy, Spain, Turkey, Austria, Kenya[80]
Residence of users entering transaction	UK, ATAF
Location of underlying property	UK, ATAF (in relation to the facilitation of rental and holiday accommodation)

79 Uruguay adopts an approach similar to this.

80 Kenya's DST Regulations also deem a user to be located in Kenya if: the payment for the digital service is made using a debit or credit facility provided by a financial institution or company located in Kenya; the digital service is acquired through an IP address registered in Kenya or a mobile phone whose country code is assigned to Kenya; or the user has a business, residential or billing address in Kenya.


TAXES

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Administrative Issues

Taxation of the digital economy raises various administrative challenges for tax administrations. In most instances, countries are seeking to tax non-residents providing digital services remotely, without any physical or legal presence in the taxing jurisdiction. Traditional administrative mechanisms for reporting and collection, as well as investigation and audit, are typically not suited to this context. However, many of these challenges are not new and have been considered in the context of VAT and other rules.

This section surveys existing country approaches before considering how administrative mechanisms, used in other contexts, could be built on to address such issues.

5.1 COUNTRY LEVEL MEASURES

Rules governing digital services tax are a new phenomenon and, for many countries, administrative aspects are still in the process of being formulated or strengthened. However, several countries have already implemented comprehensive administrative rules to maximize collection from non-resident digital businesses.

A preliminary issue is the mechanism for tax collection. Several countries, including Malaysia, Pakistan, and Mexico, have sought to tax the digital economy through a withholding tax regime, whereby the resident taxpayer withholds a percentage of outbound payments for digital services. Like traditional withholding taxes on royalties, interest, and dividends, the resident payee is required to withhold on behalf of the non-resident recipient. However, this is not always sufficient for DSTs, particularly in situations where the scope covers revenue neither received nor paid in the taxing jurisdiction. For example, advertising targeted at users in the taxing jurisdiction may be paid for by non-resident advertisers, or fees paid to accommodation platforms may be paid by non-residents tourists or owners, despite the underlying property being located in the taxing jurisdiction. In addition, some fees may be collected by deductions from amounts due to businesses, rather than paid directly by such businesses. For example, an accommodation platform may collect accommodation sales revenue from its customers and deduct its own service fees from the remittance to the accommodation provider.

DST regimes, in general, require the non-resident to register and pay taxes remotely. Many MNEs will have more than one group member earning in-scope revenue within the taxing jurisdiction. To simplify matters, several countries have introduced a system to require one group member to be nominated as the "responsible taxpayer", and is required to register, file and pay all DST liabilities on behalf of all group members. Other countries are silent on the issues, which suggests that each MNE group member would be responsible for their own compliance and could result in multiple registrations and filings per MNE group.

COUNTRY	RESPONSIBLE TAXPAYER
France	Each person receiving the revenues.
Uruguay	In the absence of a withholding agent, each non-resident service provider.
Spain	Each taxpayer, or a representative where the taxpayer is not established in the European Union.
Italy	Where an MNE group has, or could have, multiple taxpayers, a single member of the group must be appointed. Non-residents must apply for a taxpayer identification number.
UK	Generally, the parent of the group, unless a nomination is made otherwise.
Austria	Each taxpayer earning a fee for the performance of an online advertising service.
Kenya	A non-resident person may register under a simplified online DST registration scheme or appoint a tax representative. That person must then submit a return remit the tax due.

Taxpayers or responsible members would typically need to register with the tax administration and provide certain information, such as the details of the responsible member, details of the ultimate parent company, the start of the first taxable period, a contact person, and other information.[81] Under the French rules, which requires the DST payable to be declared in the French VAT return, the responsible taxpayer must appoint a local French representative (even if unrelated to the MNE group) where the taxpayer is not in the EU or in a jurisdiction with which France has an administrative assistance mechanism. It is interesting to note that France envisages using multilateral administrative assistance agreements[82] to support the collection of tax from non-resident service providers.

Article 300.IV France Digital Services Tax Legislation

> "Where the taxpayer is not established in the European Union or in any other State party to the agreement on the European Economic Area that has concluded with France an administrative assistance agreement to combat tax fraud and avoidance as well as a mutual assistance agreement for tax recovery, it shall appoint to the tax administration a representative liable to value added tax[83] established in France who commit, where appropriate, to accomplish the formalities in the name and on behalf of the represented and to pay the tax."

Some countries, such as the United Kingdom,[84] have established systems to allow for online registration and filing of returns through online portals. There are many examples of such systems being established for VAT, particularly in relation to digital services. Countries have also had to consider penalties or other measures to deter non-compliance. Most regimes rules include penalties for failure to deliver returns and, in the absence of a return, the UK rules enable the tax administration to determine the DST chargeable based on the officer's best information and belief.[85]

Record keeping requirements are relevant when thinking about DST implementation. DSTs typically sit outside of existing income tax frameworks and there is often a need to establish new and specific record keeping requirements and/or penalty provisions. This is important to ensure information in DST returns, and the basis for calculating the liability, can be verified by tax administrations. However, there are still challenges with investigation processes, given taxpayers are typically non-residents.[86] A summary of the UK's record keeping requirements is provided below:

81 See for example, UK's Digital Services Tax Manual, accessed at https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst53000
82 For example, The Convention on Mutual Administrative Assistance in Tax Matters
83 The tax will then have to be declared in the annex of the CA3 French VAT return
84 The online portal is part of the "Government Gateway".
85 UK DST Legislation Schedule 1 Part 5.
86 This may in part be overcome by exchange of information and collection mechanisms in tax treaties and multilateral conventions.

Schedule 1, Part 3 UK Digital Services Tax Legislation

6. (1) This paragraph applies in relation to a group for an accounting period if the responsible member is required by section 17 to deliver a DST return for that period.

(2) The responsible member must—

(a) keep such records as may be needed to enable it to deliver a correct and complete the DST return, and

(b) preserve those records in accordance with this paragraph.

(3) The records must be preserved until the end of the relevant day.

(4) In this paragraph "relevant day" means—

(a) the sixth anniversary of the end of the accounting period, or

(b) such earlier day as may be specified (and different days may be specified for different cases).

(5) The records required to be kept and preserved under this paragraph include records of all receipts and expenses relating to digital services activities.

France has similar record keeping requirements and requires that "such information shall be kept at the tax authorities' disposal and provided to them on first request".[87]

5.2 EXPANDING ACCESS TO ASSOCIATED PROCESSES: VAT AND PLATFORM REPORTING

Existing mechanisms for reporting and paying VAT or GST due from non-resident digital services providers could be used for administering DSTs. Collection of VAT and GST from digital services is an issue on which there is broad international consensus, largely embodied in the OECD's International VAT/GST Guidelines. More than 50 countries have adopted the Guidelines' recommendations for imposing VAT on the direct supply to consumers of services and intangibles by foreign suppliers, including most OECD and G20 countries. The approach to securing VAT due on digital goods and services supplied to local consumers by foreign suppliers is essentially the same as for physical goods. Foreign suppliers selling directly to customers are responsible for accounting for the VAT due on those transactions. They register through a simplified process online and account for tax payable on sales to consumers. This mechanism is potentially available to include the reporting, and then payment, of DSTs. Further work is needed to explore this potential.

In addition, DST compliance could rely on other mechanisms that currently collect information from digital platforms used by domestic sellers. Some countries have introduced mechanisms for collecting and reporting information about domestic sellers using digital platforms to sell goods or services (such as, for example hotel accommodation), to strengthen domestic tax compliance. In July 2020, the OECD published model rules designed to be part of a systematic international process for collecting and sharing information about sellers using digital platforms to sell services.[88] The purpose of the system is to "ensure that taxpayers and tax administrations get timely access to high-quality information on the consideration earned by platform sellers, in order to enhance compliance and minimize compliance burdens for tax administrations and taxpayers alike." The proposed rules are focused on the reporting of income from renting real property and from the provision of personal services in the sharing and gig economy. Although the main focus of the model rules is to enhance the direct taxation compliance of sellers, the same mechanisms may have the potential to allow digital service providers to report their liability for DST. Further work would be useful to explore the potential for expanding the mechanisms to report, for example, the fees received by a platform operator from a hotel in addition to the amounts paid to the hotel by or through the operator.

87 Article 300.III
88 https://www.oecd.org/ctp/exchange-of-tax-information/model-rules-for-reporting-by-platform-operators-with-respect-to-sellers-in-the-sharing-and-gig-economy.pdf; July 2020; page 3


6.

Conclusions

Taxation of the digital economy has been the subject of international debate for over two decades, but international consensus remains elusive. In the meantime, the challenges have become increasingly acute, and the need for international agreement more urgent, as digitalization continues to transform social, business, and economic activity. These challenges are being exacerbated by the COVID-19 pandemic, which has accelerated digital transformation, benefited many digitalized MNEs and placed economic and fiscal strains on governments worldwide. Income tax policy responses are coming to a head with deadlines for the G20/OECD Inclusive Framework project being delayed. Whilst the recent statement by 130 Inclusive Framework members provides some confidence, there is still uncertainty over whether and when an international consensus will ultimately be achievable and implemented. Accordingly, countries are increasingly implementing alternative approaches to ensure taxation of highly digitalized business models. At least 20 countries have implemented measures to tax income derived from digital services, and in the last year many other governments have announced consultations or proposals to move in the same direction.

Existing international tax principles do not sit easily with highly digitalized business models. Many countries are already taking measures to bridge the gap between the digital reality and long-standing international taxation principles, through direct taxation measures such as withholding taxes, expanded PE rules, or DSTs. There appears to be a solid policy grounding for implementing such measures, and their policy objectives at least partly overlap with those of existing practices (for example, source taxation of service income) and existing principles (for example, Article 12A (Fees for Technical Services)) in the UN Model Convention. The new draft Article 12B to the United Nation Model Taxation Convention narrows the gap further.

It is to be hoped that a multilateral consensus approach to taxation of the digital economy, such as that under development by the Inclusive Framework can be achieved to resolve many of these issues. Inevitably, many of the country rules discussed here depart to varying extents from existing treaty principles, creating the potential for dispute, double taxation, and uncertainty. The DSTs described in this paper are seen by many countries as transitional measures pending an acceptable outcome at global fora, allowing existing international principles to catch up with the digital business environment and resolving uncertainties about the application of treaties to these issues.[89]

Characterizing digital transactions as services provided to residents of a jurisdiction, and directly taxing the income derived from services, appears to be a sound and effective mechanism for bridging these gaps. Doing so could be viewed as building digital context

89 The finalisation by the UN of Article 12B represents a welcome attempt to address these treaty issues.

into existing international principles governing the taxation of services (found in the UN Model Taxation Convention, bilateral tax treaties and in domestic rules), rather than representing a fundamental change in those principles.

A survey of existing DSTs reveals that the design elements vary widely. The features of existing country responses provide a useful platform and framework for further debate, and a useful reference point for policymakers. As a starting point, further work on some of the theoretical underpinnings would be instructive, including on the definition of 'services', the distinction between 'service provision' and 'consumption', and the implications for tax treaties. Administrative and collection mechanisms are also important considerations, given the lack of physical presence of many potential taxpayers. There appears to be natural overlaps and synergies with administrative approaches to VAT and other initiatives and these should be explored further.

The Inclusive Framework's 2021 statements are welcome; however the design of DSTs remains important given remaining uncertainties in the design and implementation of a consensus solution. They will also remain relevant to the many non-members of the inclusive framework[90] who may wish to explore or refine existing measures that achieve source taxation of digital service providers. With many governments under unprecedented fiscal strain and with digital activity accelerating, it is reasonable to expect that these measures could remain relevant for some time. The analysis in this paper is intended to be a starting point for assessing the legislative and administrative responses available. Moreover, the policy frameworks discussed in this paper might contribute to the international debate on a more aligned approach for the design of "interim" DSTs.

90 Or members who do not register agreement with the 2021 statements.

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Annex 1: International, Regional and Country Summaries

INTERNATIONAL SUMMARIES

UN ARTICLE 12B

Implementation Date	To be included in the UN's 2021 update to the model tax convention.
Part of Income Tax Regime	Treaty provision.
Tax Rate	Not specified.
De Minimis Threshold – Global	N/A
De Minimis Threshold – Local	N/A
Scope – Activity Covered	Income from automated digital services, which means "any payment in consideration for any service provided on the internet or an electronic network requiring minimal human involvement from the service provider". They include: - Online advertising services; - Online intermediation platform services; - Social media services; - Digital content services; - Cloud computing services; - Sale or other alienation of user data; - Standardized online teaching services. It does not, however, include payments qualifying as 'fees for technical services' under Article 12A.
Attribution Principles	"Income from automated digital services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State." The term "arising in" generally means, means that any income sourced in that state (i.e paid by residents of that state or PEs in that state).

REGIONAL SUMMARIES

EU PROPOSAL

Implementation Date	N/A – Proposal was not adopted by EU but may be revisited in 2020 and 2021	
Part of Income Tax Regime	No	
Tax Rate	3% of in-scope revenue, excluding VAT and similar taxes	
De Minimis Threshold - Global	€750m of Revenues (Group) in prior financial year	
De Minimis Threshold - Local	€50m of Taxable Services (Group) in EU Member States in prior financial year	
Scope – Activity Covered	*Internet Advertising*	"The placing on a digital interface of advertising targeted at users of that interface"
	Intermediary Services	"The making available to users of a multi-sided digital interface which allows 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"
	Data	"the transmission of data collected about users and generated from users' activities on digital interfaces."

Scope – Exclusions	*Activity Exclusions*	Broadly, activity that relating to a digital interface providing users with the following: Digital content, communication services, payment services, crowdfunding, and various financial services
Nexus Principles	*Internet Advertising*	"The advertising in question appears on the user's device at a time when the device is being used in that Member State in that tax period to access a digital interface;"
	Intermediary Services	"If the service involves a multi-sided digital interface that facilitates the provision of underlying supplies of goods or services directly between users, the user uses a device in that Member State in that tax period to access the digital interface and concludes an underlying transaction on that interface in that tax period;" or; "If the service involves a multi-sided digital interface of a kind not covered by point (i), the user has an account for all or part of that tax period allowing the user to access the digital interface and that account was opened using a device in that Member State."
	Other	"Data generated from the user having used a device in that Member State to access a digital interface, whether during that tax period or any previous one, is transmitted in that tax period."
Attribution Principles	*Internet Advertising*	The proportion of an entity's total taxable revenues that is treated as obtained in a Member State shall be "in proportion to the number of times an advertisement has appeared on users' devices in that tax period;"
	Intermediary Services	The proportion of an entity's total taxable revenues that is treated as obtained in a Member State shall be, "if the service involves a multi-sided digital interface that facilitates the provision of underlying supplies of goods or services directly between users, in proportion to the number of users having concluded underlying transactions on the digital interface in that tax period;" or "if the service involves a multi-sided digital interface of a kind not covered by point (i), in proportion to the number of users holding an account for all or part of that tax period allowing them to access the digital interface."
	Data	The proportion of an entity's total taxable revenues that is treated as obtained in a Member State shall be "in proportion to the number of users from whom data transmitted in that tax period has been generated as a result of users having used a device to access a digital interface, whether in that tax period or a previous one."
Determination of Location of Users	The location of a user's device "shall be determined by reference to the Internet Protocol (IP) address of the device or, if more accurate, any other method of geolocation." The EU proposal specifically rejects that the location of the underlying supply of goods/services or the place of payment could be used to determine the location of the taxable services.	

ATAF SUGGESTED APPROACH

Implementation Date	Published September 30, 2020	
Part of Income Tax Regime	Not specified.	
Tax Rate	Suggested corridor of 1%-3%	
De Minimis Threshold - Global	De minimis thresholds included but amount not specified	
De Minimis Threshold - Local	De minimis thresholds included but amount not specified	
Scope – Activity Covered	*Internet Advertising*	"Online advertising services means the inclusion in a digital interface, of its own or of third parties, of adverts directed to the users of that interface."
	Intermediary Services	"Services delivered through an online marketplace or intermediation platform, including an accommodation online marketplace, a vehicle hire online marketplace and any other transport online marketplace;" "An "online marketplace" means an online platform which facilitates the sale or provision by users of any services, goods or other property to other users."
	Data	"Data services means the sale or license of, or access to user data or information collected through user engagement with an online platform, whether it is sold or licensed directly or indirectly, aggregated or disaggregated, anonymized or used in any other form."
	Other	- Online gaming services - Cloud computing services - Services other than those services above, delivered through a social media platform - Services, other than those services above, delivered through an internet search engine - Any other digital services which meets the general definition of digital services
Attribution Principles	*Internet Advertising*	Digital services revenue is directly attributed to a country (i.e. when it is derived from residents) or, under an alternative attribution mechanism for internet advertising, is attributed to the country based on the number of country users viewing the advertising as a percentage of global users viewing the advertising.
	Intermediary Services	Generally digital services revenue is directly attributed to the country (i.e. derived from residents). In the case of online accommodation services (eg hotel rentals) it is attributed based on the location of the underlying property. In the case of private vehicle hire services, it is attributed based on where the journey commenced.
	Data	Digital services revenue is directly attributed to a country (i.e. when it is derived from residents) or, under an alternative attribution mechanism for data services, is attributable to the country based on the number of country users as a percentage of global users.
	Other	Generally digital services revenue is directly attributed to the country (i.e. derived from residents).

Determination of Location of Users	There are different rules with respect to each type of service as to how the location of users is determined (and therefore whether revenue is attributed to a particular country). In general, a hierarchy approach is adopted where, if the primary indicator of a user's location is not available to the taxpayer, a second or third indicator of location will be used. With regards to internet advertising, data and other digital services the hierarchy is :1. User Profile; 2. Geolocation of Device; 3. IP address. With regards to intermediary services the hierarchy is: 1. The physical address of delivery (for buyers) or the registered account address or billing address (sellers); 2. Geolocation of Device; 3. IP address.

COUNTRY SUMMARIES

INDONESIA

Implementation Date	March 31, 2020
Part of Income Tax Regime	Yes
Tax Rate	Generally subject to corporate income tax rates
De Minimis Thresholds	N/A
Scope – Activity Covered	Foreign e-commerce providers will potentially be subject to the following taxes: • Corporate Income Tax payable by deeming a virtual PE where foreign e-commerce companies have a significant economic presence in Indonesia. • Where a tax treaty prevents the application of income tax of virtual PE, an electronic transaction tax will be imposed on sales to Indonesian buyers/users
Attribution Principles	Not specified.
Nexus Principles	Further implementing measures will be required to provide a definition of significant economic presence, however it will be based on the following factors: • Consolidated gross turnover of the business group; • Sales in Indonesia; • Number of active users on digital media in Indonesia.
Determination of Location of Users	N/A.

ITALY

Implementation Date	January 1, 2020
Part of Income Tax Regime	No
Tax Rate	3% of in-scope revenue, excluding VAT
De Minimis Threshold – Global	€750m of Revenue (Group) in prior calendar year
De Minimis Threshold – Local	€25m of Taxable Services (Group) in prior calendar year

Scope – Activity Covered	*Internet Advertising*	"Transmission on a digital advertising interface aimed at users of the same interface"
	Intermediary Services	"The making available, by electronic means, of a digital interface which allows users to find other users and to interact with them, in particular for the supply of goods or services directly between such users."
	Data	"Transmission of data collected from users and generated by the use of a digital interface."
Scope – Exclusions	*Activity Exclusions*	Broadly, activity that relating to a digital interface providing users with the following: Digital content, communication services, payment services and regulated financial services by regulated financial entities (including the transmission of data).
Nexus Principles	*Internet Advertising*	"The advertisement appears on the user's device when the device is used in the territory of the State in the said tax period to access a digital interface"
	Intermediary Services	"In the case of sales of goods/services between users, "the user uses a device in the territory of the State in the said tax period to access the digital interface and concludes a corresponding operation on this interface in the said tax period". For other intermediary services, "the user has an account for all or part of this tax period which allows him to access the digital interface and this account was opened using a device in the State territory"
	Other	"The data generated by the user who used a device in the territory of the State to access a digital interface, during that tax period or a previous tax period, and they are transmitted during that tax period"
Attribution Principles	Not specified.	
Determination of Location of Users	The device shall be deemed to be used in Italy mainly by reference to the internet protocol (IP) address of the device or any other form of geolocation.	

KENYA

Implementation Date	1st January 2021
Part of Income Tax Regime	Yes
Tax Rate	1.5% of gross transaction value
De Minimis Threshold -- Global	N/A
De Minimis Threshold -- Local	N/A
Scope – Activity Covered	Digital services includes: (a) downloadable digital content including downloadable mobile applications, e-books and films; (b) over-the-top services including streaming television shows, films, music, podcasts and any form of digital content; (c) sale of, licensing of, or any other form of monetizing data collected about Kenyan users which has been generated from the users' activities on a digital marketplace; (d) provision of a digital marketplace; (e) subscription-based media including news, magazines and journals;

Scope – Activity Covered	(f) electronic data management including website hosting, online data warehousing, file-sharing and cloud storage services; (g) electronic booking or electronic ticketing services including the online sale of tickets; (h) provision of search engine and automated held desk services including supply of customized search engine services; (i) online distance training through pre-recorded media or e-learning including online courses and training; and (j) any other service provided through a digital marketplace.
Attribution Principles	"A person shall be subject to digital service tax if the person provides or facilitates provision of a service to a user who is located in Kenya." "The digital service tax shall be imposed on the gross transaction value of the service."
Nexus Principles	None Specified.
Determination of Location of Users	A user of a digital service shall be deemed to be located in Kenya if— (a) the user receives the digital service from a terminal located in Kenya, where terminal includes a computer, tablet and mobile phone; (b) the payment for the digital service is made using a debit or credit facility provided by a financial institution or company located in Kenya; (c) the digital service is acquired through an internet protocol address registered in Kenya or an international mobile phone country code assigned to Kenya; or (d) the user has a business, residential or billing address in Kenya.

NEW ZEALAND

Implementation Date	Public Consultation (Broad Proposal Only)	
Part of Income Tax Regime	No	
Tax Rate	3% of in-scope gross revenues	
De Minimis Threshold - Global	€750m of Revenue (Group) in prior calendar year	
De Minimis Threshold - Local	NZD 3.5m of in-scope revenue in prior calendar year[91]	
Scope – Activity Covered	*Internet Advertising*	Social media platforms, online content sharing sites and search engines.
	Intermediary Services	Intermediation platforms, which facilitate the sale of goods or services between people.
	Other	Sale of user data.
Scope – Exclusions	*Intra-group*	Services/transactions between members of the same group
Nexus Principles	Would likely include anyone who views or clicks on the advertisement (with the same person possibly counting as multiple users if they view or click on it multiple times) or a person who enters into a transaction using the platform (to either buy or sell), with each transaction counting as a separate user.	
Attribution Principles	Allocation of global in-scope revenue based on numbers of users in New Zealand as percentage of total users.	

91 The definition of in-scope revenue was not provided in the consultation document

Determination of Location of Users	Based on the location of the user, determined in the same manner as VAT laws, which is based on: - The person's billing address; - The IP address; - The bank details; - The mobile country code or landline; or - Other commercially relevant information

NIGERIA

Implementation Date	October 14, 2019
Part of Income Tax Regime	Yes
Tax Rate	Subject to income tax rates
De Minimis Thresholds	N/A
Scope – Activity Covered	"A company shall be taxable in Nigeria if it transmits, emits or receives signals, sounds, messages, images or data of any kind by cable, radio, electromagnetic systems or any other wireless apparatus to Nigeria in respect of any activity, including electronic commerce, application store, high frequency trading, electronic data storage, online adverts, participative network platform, online payments and so on, to the extent the company has significant economic presence and profit can be attributable to such activity." "If the trade or business comprises the furnishing of technical management, consultancy or professional services outside of Nigeria to a person resident in Nigeria, to the extent the company has significant economic presence and profit can be attributable to such activity"
Attribution Principles	Not specified.
Nexus Principles	"Significant Economic Presence", which may be defined by the Order of the Minister of Finance.
Determination of Location of Users	N/A.

SPAIN

Implementation Date	January 1, 2021
Part of Income Tax Regime	No
Tax Rate	3% of in-scope revenue, excluding VAT and similar taxes
De Minimis Threshold – Global	€750m of Revenue (Group) in prior calendar year
De Minimis Threshold – Local	€25m of Taxable Services (Group) in prior calendar year

Scope – Activity Covered	*Internet Advertising*	""Those (services) consisting of the inclusion in a digital interface, of its own or of third parties, of advertising directed to the users of said interface. When the entity that includes the advertising does not own the digital interface, it will be considered as provider of the advertising service to that entity, and not the entity that owns the interface."
	Intermediary Services	"Those (services) made available to users of a multifaceted digital interface (which allows interacting with different users concurrently) that facilitates the delivery of underlying goods or services directly between users, or that allows them to locate other users and interact with them."
	Other	"Those (services) of transmission with consideration, including the sale or assignment, of those collected about users, which have been generated by activities developed by the latter in the digital interfaces."
Scope – Exclusions	*Intra-group*	Broadly, services provided between members of the same group
	Activity Exclusions	Online sales of goods/services (without intermediary) Delivery of goods obtained under an intermediary service Intermediary services for the purposes of delivering digital content, telecommunications, or payments Regulated financial services (including data transmission)
Nexus Principles	*Internet Advertising*	""When at the time the advertising appears on that user's device the device is in that territorial area"
	Intermediary Services	""When the conclusion of the underlying operation by a user is carried out through the digital interface of a device that at the time of conclusion is in that territorial area." Or "when the account that allows the user to access the digital interface has been opened using a device that at the time of opening is in that territorial area"
	Other	"When the transmitted data has been generated by a user through a digital interface that has been accessed through a device that at the time of data generation is found in that territorial scope."
Attribution Principles	*Internet Advertising*	Total income from the activity is attributed based on "the proportion that represents the number of times the advertising appears on devices that are in the territory of application of the tax will be applied to the total number of times that such advertising appears on any device, regardless of where they are located."
	Intermediary Services	Total income from the activity attributed based on "the proportion that represents the number of users located in the territory of application of the tax with respect to the total number of users involved in that service, whatever the place where they are located."
	Other	Total income from the activity attributed based on "the proportion that represents the number of users who have generated such data that are located in the territory of application of the tax with respect to the total number of users"
Determination of Location of Users	Broadly, based on the IP address of the device at the relevant point-in-time that the digital interface was consulted, however evidence to the contrary could be allowed to disprove this assumption.	

TURKEY

Implementation Date	March 1, 2020	
Part of Income Tax Regime	No	
Tax Rate	7.5%, though president has power to reduce to as low as 1% or increase to as high as 15%	
De Minimis Threshold - Global	€750m of Revenue (Group) in prior calendar year	
De Minimis Threshold - Local	TRY20m (Approximately €3m) of Turkish DST revenue	
Scope – Activity Covered	*Advertising services*	Broadly, all kinds of advertising services provided through digital media
	Intermediation Services	Broadly, the provision and operation of digital media enabling users to interact with each other (including services aimed at the sale or facilitation of sale of goods or services between users)
	Digital Content	Broadly, the sale of audio, visual or digital content through digital media and services relating to audio, visual or digital content
Scope – Exclusions	*Activity Exclusions*	Broadly, certain banking, payment and communication services
Attribution Principles	None specified.	
Nexus Principles	*All*	The tax is applied to the provision of services in Turkey, which includes the following: • The service is provided in Turkey; or • The service benefit is enjoyed in Turkey; or • The service targets individuals located in Turkey; or • The services is used in Turkey (which, broadly, means paid for from Turkey).

UK

Implementation Date	April 1, 2020	
Part of Income Tax Regime	No	
Tax Rate	2% of in-scope revenue exceeding £25m, excluding VAT and similar taxes	
De Minimis Threshold – Global	£500m of Digital Services Revenue (Group) in the relevant income year	
De Minimis Threshold – Local	£25m of Digital Services Revenue (Group) in the relevant income year	
Scope – Activity Covered	*Social Media Platforms*	"An online platform that meets the following conditions— (a) the main purpose, or one of the main purposes, of the platform is to promote interaction between users (including interaction between users and content on the platform provided by other users); (b) the platform enables content to be shared with other groups of users (or with other users)."

Scope – Activity Covered	*Online Marketplaces*	"An online platform that meets the following conditions— (a) the main purpose, or one of the main purposes, of the platform is to facilitate the sale by users of particular things; (b) the platform enables users to sell particular things on the platform to other users, or to advertise or otherwise offer to other users particular things for sale."
	Internet Search Engines	Not specifically defined.
Scope – Exclusions	*Activity Exclusions*	Broadly, online financial marketplaces.
Nexus Principles	*Internet Advertising*	"In the case of online advertising revenues, the advertising is intended to be viewed by UK users;"
	Online Marketplaces	"When the conclusion of the underlying operation by a user is carried out through the digital interface of a device that at the time of conclusion is in that territorial area." Or "when the account that allows the user to access the digital interface has been opened using a device that at the time of opening is in that territorial area"
	Other	"When the transmitted data has been generated by a user through a digital interface that has been accessed through a device that at the time of data generation is found in that territorial scope."
Attribution Principles	"The revenues are to be treated as attributable to UK users to such extent as is just and reasonable."	
Determination of Location of Users	Broadly, based on the IP address of the device at the relevant point-in-time that the digital interface was consulted, however evidence to the contrary could be allowed to disprove this assumption.	

URUGUAY

Implementation Date	January 1, 2018	
Part of Income Tax Regime	Yes - under the Income Tax on Non-Residents	
Tax Rate	Audio-visual services: 12% (withholding) Intermediation services: 12% (direct charge)	
De Minimis Thresholds	None specified	
Scope – Activity Covered	*Online Content*	Broadly, audiovisual services rendered directly through the internet.
	Intermediation Services	Mediation and intermediation in the supply or demand of services provided digitally is defined as activities that: Are basically automated, require minimal human intervention, and are not viable without information technology; and Intervene in the supply or demand of services.
Scope – Exclusions	*Activity Exclusions*	Broadly, income derived from publicity, propaganda, and technical services (including distant learning)
Attribution Principles	None specified.	

Nexus Principles	*Online Content*	Broadly, income from the supply of audio-visual content provided digitally is considered sourced entirely in Uruguay if the service user is in Uruguay.
	Intermediation Services	Considered 100% Uruguay sourced if both the supplier and the user are in Uruguay, and 50% Uruguay sourced if one or the other is outside Uruguay.
Determination of Location of Users	*Online Content*	Broadly, the location will be determined by reference to: The IP address of the device used for "hiring" or purchasing the service The invoicing address of the client If either of these factors cannot be verified, the service will be considered to have been rendered in Uruguay if paid via electronic means in Uruguay (e.g., by credit card, bank account transfers, etc.)
	Intermediation Services	The provider will have to verify if the main business (i.e., house rental, passenger transport) is located in Uruguay. To determine whether the acquirer is local, the location of the IP address of the device used for contracting the main service will be considered, and if not available, it will be considered local if paid via electronic means in Uruguay.

INDIA (2016) (EQUALIZATION LEVY)

Implementation Date	1 June 2016	
Part of Income Tax Regime	No	
Tax Rate	6%	
De Minimis Threshold - Global	N/A	
De Minimis Threshold - Local	100,000 Rupees	
Scope – Activity Covered	*Internet Advertising*	Online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement, or any other service as may be notified by the central government.
Scope – Exclusions	Non-resident has a PE in India or the advertisement is not for commercial purposes.	
Attribution Principles	Broadly, the levy is charged on any Indian resident or PE paying a non-resident for specified services.	

INDIA (2020) (EQUALIZATION LEVY)

Implementation Date	1 April 2020
Part of Income Tax Regime	No
Tax Rate	2%
De Minimis Threshold - Global	N/A
De Minimis Threshold - Local	20m Rupees

Scope – Activity Covered	*Sale of Goods Digitally*	Online sales of goods owned by the e-commerce operator
	Provision of Services Digitally	Online provision of services provided by the e-commerce operator
	Online Marketplace	Online sale of goods or provision of services or both, facilitated by the e-commerce operator and applies to full value.
	Other	Any combination of the above
Scope – Exclusions	Non-resident has a PE in India or the services are already captured by the 2016 levy. Payment of royalties or technical services fees already taxable under the Income Tax Act	
Nexus Principles	Applicable to e-commerce supplies or services provided to 1) persons resident in India, 2) persons who buy the goods or services using a device with an IP address in India. It can also cover services provided to non-residents in the case of 1) advertising services which target customers that are resident in India or access the advertisement through IP address located in India and 2) the sale of data collected from a user resident in India or using a device with an IP address located in India.	

Annex 2. Types of Digital Services

This Annex discusses four specific business lines, which are commonly the target of direct digital taxation measures. Many institutions have discussed, in detail, these business lines and the tax challenges that follow.[92] Much of that discussion has covered broad based descriptions of the digital economy, digital businesses and their value drivers and has been less focused on the nature and mechanics of the services provided by digital business models.

This Annex relies on the extensive commentary referred to above and does not seek to replicate or diverge from that commentary, but instead summarizes each business line in the specific context of the digital services provided and received. This is intended to build on Section 3, which suggests the most logical and practical rational for taxing digital businesses may be to focus on the services provided by those platforms and create new rules for taxing those services.

1. ONLINE ADVERTISING SERVICES

SERVICES PROVIDED:

These business lines, integrated within a wide range of online digital platforms, sell advertising space, or provide advertising services. The advertising services have the potential to be highly targeted based on the user criteria specified by the advertiser or determined by the platform (such as age, gender, preferences, location etc).

Business providing online advertising services typically leverage platforms that rely on offering users 'free' access, such as a search engine or a social network. Users of the platform typically generate data or content, as well as user engagement with the platform, which is in turn monetized, through the sale of advertising space or related services.

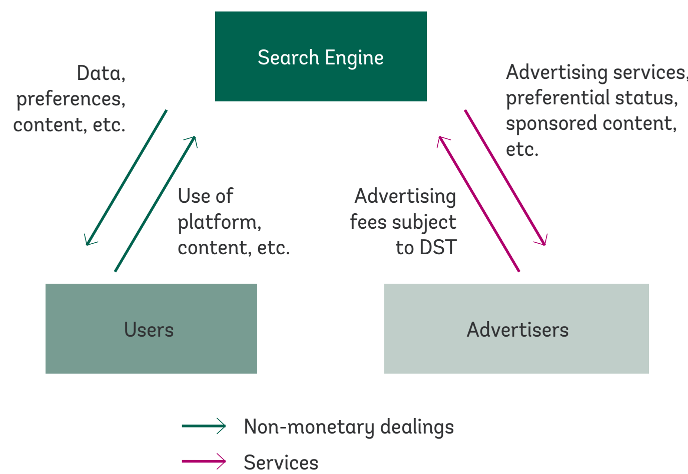
There are a wide range of business models that potentially provide online advertising services, including social media platforms, search engines, web browsers, content sharing platforms, mobile applications, music streaming services, online forums and many others.

SERVICE RECIPIENTS:

The service recipients are those contracting with the online advertiser for the advertising services. Anyone can potentially pay to advertise through these platforms; however, they are typically businesses targeting consumers. It is important to note that the service recipient is not the users accessing the platform, but the businesses or individuals paying for the advertising.

The fee structure varies significantly across and within business models. In some instances, the advertising fee is pre-determined based on the nature of the service. In other cases, advertising fees are based on the level of user engagement with the advertising, determined, for example, through the number of views, clicks or redirects. A summary is provided below:

FIGURE A1: Online Advertiser Example



2. SALE AND LICENSE OF DATA

SERVICES PROVIDED:

These business lines sell or license user data to customers. There are various forms in which data may be sold or licensed– for example aggregated or disaggregated, anonymized, or as a parameter of other services. Many social media and other businesses insist that they do not sell user data, explaining that they use it to provide advertisers and developers with better and more targeted advertising. However, some reports suggest that even these businesses grant data access to third

92 See for example, OECD "Tax challenges arising from digitalisation – interim report" 2018, EU Commission Expert Group on Taxation of the Digital Economy 2014, IMF Policy Paper "Corporate Taxation in the Global Economy" 2019,

parties (often referred to as partners) in exchange for a fee[93], whilst some commentators argue that targeted advertising is tantamount to selling data.[94]

Like online advertising, these business lines typically rely on offering users 'free' access to a service, such as a search engine or a social network, then collecting user data which is in turn monetized.

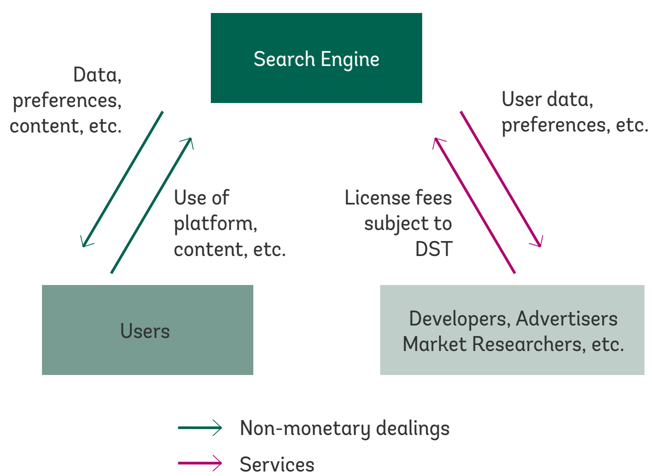
The practice of businesses collecting data on users is expanding rapidly such that data collection, at least to some degree, pervades almost all digital business models. Like online advertising, these services are typically provided by social media platforms, search engines, content sharing platforms, mobile applications, music streaming, online forums, and many others.

SERVICE RECIPIENTS:

The service recipients are those contracting with the digital platform for access to the data. Again, it is important to note that the service recipient is not the users accessing the platform but the businesses paying for the data.

Businesses paying for user data could include advertisers, developers, market researchers and many others. A summary is provided below:

FIGURE A2: Sale/License of User Data Example



3. INTERMEDIARY SERVICES

SERVICES PROVIDED:

These businesses typically provide services, through a digital platform, to buyers and sellers of goods and services. These businesses act as an intermediary between users for the sale of goods or services on the digital platform and, in return, charge a fee to the buyer and or seller.

Whilst the fee could be characterized as a payment for facilitating the transaction or accessing the platform, in many instances the platform provides users with more than mere access. For example, ride share platforms match drivers with passengers, afford drivers with greater flexibility, efficient and safer cashless transactions, identity verification, real-time route tracking and, in some cases, health and accident insurance. These are in substance the provision of a service. Accommodation share platforms match hosts with customers, and, in addition can provide the former with insurance for third party claims and mediation and dispute resolution processes (such as for guest damages). Similarly, online marketplaces for the sale of goods match buyers with sellers and often provide consumer protections and guarantees to buyers. It is realistic to characterize these activities as the provision of services.

There are a wide range of business models that potentially provide intermediary services, including short term accommodation rental platforms, travel booking sites, restaurant booking sites, online marketplaces, ride sharing, food delivery, household services, dating and many other platforms.

It should be noted that there are various online platforms that provide intermediary functions that do not charge fees to buyers and sellers. Examples include Gumtree, Facebook, Craigslist, and others. These businesses typically rely on other services, such as sale or license of data or online advertising revenue. Such revenue streams would be captured under *Section 6.1* and *Section 6.2* above.

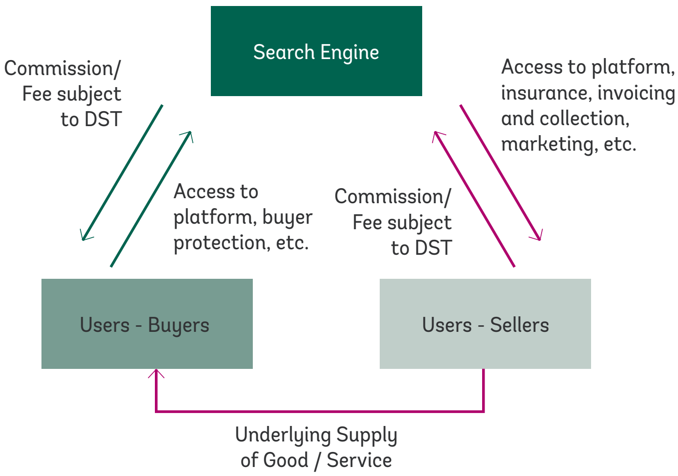
SERVICE RECIPIENTS:

The services are provided to the users buying or selling goods or services on the platform, who are charged a fee, typically for each transaction undertaken on the platform. Service recipients could be businesses, such as sellers of goods, accommodation or tourism service providers or individuals, such as ride-share passengers, tourists, private sellers of second-hand goods. Some businesses impose the fee on the

93 See for example, https://www.nytimes.com/2018/12/18/technology/facebook-privacy.html.
94 See for example, https://www.nytimes.com/2018/12/12/opinion/facebook-data-privacy-advertising.html.

seller, others on the buyer, whilst others are shared between the buyer and seller. The fee is not necessarily transparent, and, in some cases, sellers may not be aware of the fee charged to the buyer (and vice versa). A summary is provided below:

FIGURE A3: Intermediary Services Example



4. DIRECT SALE OF DIGITAL CONTENT

SERVICES PROVIDED:

These businesses provide digital content or services directly to consumers. They operate much in the same manner as goods re-sellers, dealing with customers for the sale or resale of, or access to, that digital content.

Digital content could include music, movies, videos, e-books, audiobooks, virtual reality, games, applications, digital magazines or publications etc, as well as bespoke solutions such as software, web designs and cloud computing. In some cases, the digital content seller is also the owner of the digital content, usually because it has developed the content itself. For example, many streaming services now produce their own content (such as movies or tv shows). There is no universally agreed definition of digital content and given the speed of technological transformation, the nature of digital content may evolve quickly. For example, artificial intelligence, virtual reality, and augmented reality products are already becoming more prevalent.

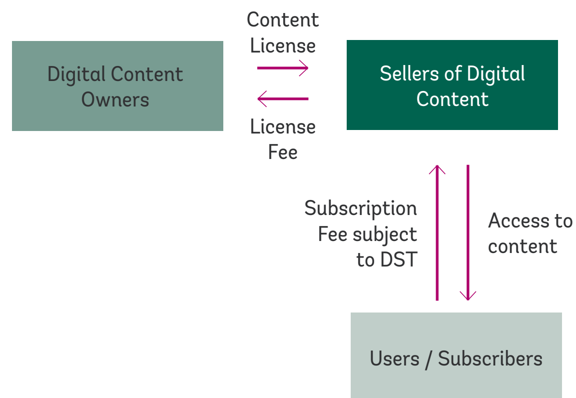
Many business models potentially provide these services, including streaming services, music services, gaming platforms, application developers and software providers.

SERVICE RECIPIENTS:

The services are provided to a wide range of recipients, including individuals and businesses. Payment is often in the form of a periodic subscription, giving the subscriber access to or use of – but not ownership of– the digital content for the duration of the subscription. Other sales are on a one-off basis, granting the user with access to the content indefinitely.

A summary is provided below:

FIGURE A4: Digital Content Example



Further consideration may be needed with regards to differentiating digital content as a service and digital content as a product. In many circumstances, providers of digital content may be characterized as sellers (or resellers) of a product, such as a book, movie or song, or a catalogue or series of products with regards to subscription-based services. This is quite distinct from the provision of a service. To date, DSTs have largely focused on capturing the provision of services. Section 5 discussed that there may be a sound policy rational for expanding international tax principles to tax, at source, the provision of services in the digital context. It may, however, be less persuasive to extend these principles to digital sales of products, particularly where consumption taxes such as VAT and GST may be better suited. For the services discussed in *Section 6.1 to 6.3* there is more clearly a service being provided by the digital platform and received by someone in circumstances where there is sufficient connection to the taxing jurisdiction.

WORLD BANK GROUP