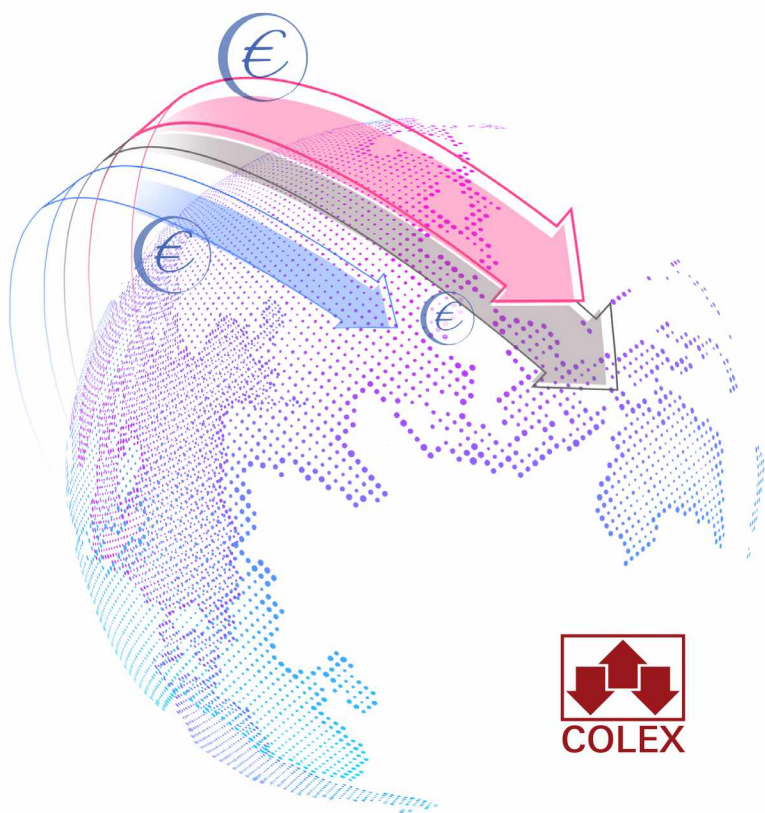

DIGITAL TAXATION: ACTIVITIES THAT WILL BE TAXED AND HOW TO IDENTIFY THEM

SILVIA VELARDE ARAMAYO



DIGITAL TAXATION: ACTIVITIES THAT WILL BE TAXED AND HOW TO IDENTIFY THEM

1st Edition

Dr. Silvia Velarde Aramayo

Tax Law Professor

Faculty of Economics and Business

University of Salamanca

COLEX 2021

Copyright © 2021

Queda prohibida, salvo excepción prevista en la ley, cualquier forma de reproducción, distribución, comunicación pública y transformación de esta obra sin contar con autorización de los titulares de propiedad intelectual. La infracción de los derechos mencionados puede ser constitutiva de delito contra la propiedad intelectual (arts. 270 y sigs. del Código Penal). El Centro Español de Derechos Reprográficos (www.cedro.org) garantiza el respeto de los citados derechos.

Editorial Colex S.L. vela por la exactitud de los textos legales publicados. No obstante, advierte que la única normativa oficial se encuentra publicada en el BOE o Boletín Oficial correspondiente, siendo esta la única legalmente válida, y declinando cualquier responsabilidad por daños que puedan causarse debido a inexactitudes e incorrecciones en los mismos.

Editorial Colex S.L. habilitará a través de la web www.colex.es un servicio online para acceder a las eventuales correcciones de erratas de cualquier libro perteneciente a nuestra editorial, así como a las actualizaciones de los textos legislativos mientras que la edición adquirida esté a la venta y no exista una posterior.

© Silvia Velarde Aramayo

© Editorial Colex, S.L.

Calle Costa Rica, número 5, 3º B (local comercial)

A Coruña, C.P. 15004

info@colex.es

www.colex.es

I.S.B.N.: 978-84-1359-379-1

Depósito legal: C 2243-2021

TABLE OF CONTENTS

PREFACE	11
INTRODUCTION	13

FIRST PART: CAN BE TAXED THE DIGITAL ECONOMY?

1. Overview and taxonomy.....	23
2. Boundaries of the digital economy.....	27
3. Digital sector and digital transactions.....	33
4. Approaches to define the digital economy.....	36
4.1. Bottom-up definitions.....	38
4.2. Top-down definitions.....	39
4.3. Flexible definitions.....	42

SECOND PART: WHAT ACTIVITIES WILL BE TAXED?

1. The «value creation»: a questioned criterion.....	47
2. Digital business models.....	49
3. Main sectors.....	54
3.1. Automated digital services.....	54
3.1.1. Activities included in the positive list.....	56
3.1.2. Activities comprised in the negative list.....	65
3.2. Consumer-facing businesses.....	69
3.3. Activities excluded from both categories.....	70
4. Tax-disruptive digital elements.....	76
5. Tax-disruptive business models.....	79
6. Multisided platforms and value creation.....	83
7. European Union proposals: taxed activities.....	87
8. MNE's included in the scope of amount «A».....	97

**THIRD PART:
WHAT ARE THE REVENUE SOURCING
RULES AND THEIR INDICATORS?**

1. The OECD and the New Diplomacy.....	101
2. The new revenue sourcing rules.....	102
2.1. Source rules for automated digital services.....	103
2.2. Source rules for consumer-facing business.....	109
3. Hierarchy of indicators.....	111
4. Indicators in automated digital business.....	112
5. Indicators in consumer-facing business.....	119
6. The Spanish approach about to the tax on digital services....	121
CONCLUSIONS.....	127
REFERENCES.....	129

PREFACE

In recent years, many International Organisations have published different proposals to face the challenges arising by the digitization, especially from a tax perspective. Undoubtedly, the work accomplished by the OECD with the support of the G20 and the Inclusive Framework (141 Countries and 14 observer Organisations) constitutes the principal axis of the current international debate about this issue although also the remarkable work of the European Union.

Taxes on the digital economy can take a variety of forms. Some are as simple as consumption taxes on internet purchases or about some services like e-Newspaper's subscriptions. Instead, other proposals attempt to collect taxes generated by new business models and, to some extent, separate digital companies from other parts of the economy. Thus, the first part of this book seeks to delve into the meaning, taxonomy, and the own boundaries of the digital economy.

The second part, tries to address some technical concepts that have very relevant tax consequences like the automated digital services or the consumer-facing businesses. The purpose is to provide an overview about which activities will be taxed, which ones are likely to be excluded, how to identify them, and what indicators will be used. Lastly, in the third part, we briefly explain how the revenue sourcing rules will be determinate in each business model according to the most recent OECD proposals.

Finally, I would like to thanks to my family for their infinite support, patience, and love. As well, of course, to the University of Salamanca which in 2018 has reached 800 years of continuous academic activity.

I further thanks to my publisher Colex, especially to its copy-editing team.

Saint Nicholas, December 2021

INTRODUCTION

In 1987 S. CNOSEN published an interesting book¹ that included a P. MUSGRAVE suggestive article² that deal with how to solve some problems creates by the capital mobility though different jurisdictions including issues as, for example, whether a jurisdiction has the right to tax certain profits and the set of rules and principles used to allocate those rights. A few years latter some scholars like GRAETZ³ have pointed out that the corporate tax rules are outdated, inadequate and unsatisfactory; and other scholars like ROSEMBLOOM⁴, even refuse the international tax system in itself⁵.

-
- 1 See CNOSEN, S. *Tax Coordination in the European Community*, Series on International Taxation, Springer Science-Business Media LLC., New York, 1987.
 - 2 See MUSGRAVE, P. B. «Inter-jurisdictional coordination of taxes on capital income», in CNOSEN, S. (editor) *Tax Coordination in the European Community*, part four, chapter eight, pp. 197-225
 - 3 See GRAETZ, M. J. «Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies», 26 *Brooklyn Journal of International Law*, issue 4, 2001.
 - 4 See ROSEMBLOOM, H. D. «International Tax Arbitrage and the International Tax System», 53 *Tax Law Review*, issue 137, 2000.
 - 5 AVI-YONAH has illustrated the situation in these words: «In 1998, I engaged in a debate with professor H. David Rosenbloom of New York University in which he denied both: the existence of a «international tax regime» and the validity of the single tax principle. Subsequently, other well-known tax professors like Michael Graetz, Julie Roin, and Dan Shaviro have taken Rosenbloom's position by denying the existence or utility of an international tax regime....». See AVI-YONAH, R. S. «Who invented the Single Tax Principle? An essay on the History of U.S. Treaty Policy», 59 *New York Law School Law Review*, issue 2, 2015, pp. 307.

On the other hand if we think that, under the European Commission data⁶, the World Wide Web (www) – developed by Tim Berners-Lee and officially announced in 1991 – moves, each day, 650 million of internet searches, 800 videos watched online, 20 billion emails sent, 150 million social media posts, 40 million photos uploaded, and an internet traffic of 400 million gigabytes, we can understand why in the last years the average of the annual revenue growth for the top digital firms was around 14% compared to 3% for IT/Telecoms and 0.2% for others MNE's⁷. Nevertheless it's more complicated, or perhaps not, to understand why companies with digital business models – according to the European Commission and ZEW information – *pay less than half* of the tax rate paid for business with traditional models, namely, an effective tax rate of 9.5% in comparison with the 23.2% for the second one⁸.

In this context, recent economic studies have reviewed the digitalization challenges in the direct (corporate profits) and indirect (consumption) taxation and have evaluated the current development at the EU and OECD levels and supports the idea that there is no justification for introducing

6 See EUROPEAN COMMISSION, Communication from the Commission to the European Parliament and the Council, *Time to establish a modern, fair, and efficient taxation standard for the digital economy*, COM (2018) 146 final, Brussels March 21, 2018.

7 «Close to a third of the growth of Europe's overall industries output is already due to the uptake of digital technologies. In 2006, only one digital company was among the top 20 firms by market capitalisation whereas in 2017, already 9 digital companies were among the top 20. Between 2008 and 2016, the annual average growth of revenues of the top 5 e-commerce retailers amounted to a staggering 32%, compared to only 1% in the whole EU retail sector. Between 2006 and 2016, digital advertising revenue in Europe has multiplied by more than 5». See EUROPEAN COMMISSION, Commission Staff Working Document, *Impact Assessment*, SWD (2018) 81 final/2, Brussels March 21, 2018, pp. 10.

8 «Based on stylised business models ZEW has established that a cross-border digital business model is subject to an effective average tax rate of 9.5% in comparison with a rate of 23.2% of cross-border traditional business». See EUROPEAN COMMISSION; Commission Staff Working Document, *Impact Assessment*, SWD (2018) 81 final/2, Brussels March 21, 2018, page 18; CENTRE FOR EUROPEAN ECONOMIC RESEARCH (ZEW), *Effective tax levels using the Devereux/Griffith Methodology*, Project TAXUD/2013/CC/120, Final Report 2017, Mannheim, January 2018 (see also the Final Report 2016).

a new tax order for digital business because it could distort corporate decisions and tax competition⁹. Respect of this, well know scholars like **BAUER** believes that a tax on digital revenues would not only stand in opposition to tax efficiency and neutrality but it would also undermine digitalisation and the digital single market¹⁰. **BEKER** and **ENGLISCH** have mentioned that in their opinion, the project for the European Digital Services Tax is a populist and flawed proposal¹¹. As well **OLBERT** and **SPENGL** have highlighted that there is no empirical evidence that the digital firms pay systematically less taxes than traditional firms¹².

Instead for the European Commission, currently the corporate tax rules are outdated, cumbersome and lend themselves to the abuse¹³; and at global level we need a new, modern, and fair corporate tax system, capable to connect the international tax rules with the technical and digital developments. Against this background, the European Commission has focused in three projects: the proposal for a new Directive on Corporate Taxation of a Significant Digital Presence (DSP)¹⁴, a proposal for a new Directive of a Digital Services Tax (DST)¹⁵, and to relaunch the 2011 proposal for

-
- 9 See OLBERT, M. and SPENGL, C. «Taxation in the digital economy. Recent Policy Developments and the Question of Value Creation», *ZEW Discussion Paper* 19-010, April 2019, pp. 24.
 - 10 BAUER has argued that «real world financial data show that the average corporate tax rates of many digital companies actually exceed the European Commission's «hypothetical» estimates by about 20 to 50 percentage points». See BAUER, M. «Digital Companies and their Fair Share of Taxes: Myths and Misconceptions», *European Centre for International Political Economy (ECIPE) Occasional Paper* núm. 03/2018, pp. 2.
 - 11 See BEKER, J. and ENGLISCH, J. «EU Digital Tax Services. A Populist and Flawed Proposal», *Kluwer International Tax Blog*, March 18, 2018.
 - 12 See OLBERT, M. and SPENGL, C. «Taxation in the digital economy. Recent Policy Developments and the Question of Value Creation» footnote 9.
 - 13 See EUROPEAN COMMISSION, *A fair share: Taxation in the EU for the 21st Century*, Luxemburg, 2018, pp. 8-9.
 - 14 See EUROPEAN COMMISSION, *Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence*, COM (2018) 147 final, Brussels March 21, 2018.
 - 15 See EUROPEAN 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*, COM (2018) 148 final, Brussels March 21, 2018.

a Common Corporate Tax Base (CCTB)¹⁶. The first and third proposal were presented as «structural solutions» and the second one was defined like an interim solution.

On the other hand, the OECD has work about the digital taxation in the frame of the Base Erosion and Profit Shifting Project (BEPS)¹⁷; more specifically, in the context of Action 1 (tax challenges arising from digitalisation)¹⁸ and Action 7 (permanent establishment status)¹⁹. In 2018 this Organisation²⁰ identify four categories of uncoordinated and unilateral actions: (1) Some alternative applications as regard the permanent establishment notion; (2) The use of withholding taxes; (3) The use of turnover taxes; and (4) The introduction of specific regimes targeting large MNE's. However how PINTO²¹ has explained, it is worth remembering that the initial OECD work (2015) was pointed to five options: (a) Modify the exemptions for the permanent establishment contained in article 5.4 of the OECD Model Tax Convention; (b) Establish a new nexus for determining the PE status based on a significant digital presence; (c) Replace thresholds with a «significant presence test»; (d) Create a withholding tax for digital transactions; and (e) Introduce a bandwidth or bit tax.

-
- 16 See EUROPEAN COMMISSION, *Proposal for a Council Directive on a Common Corporate Tax Base (CCTB)*, COM (2016) 685 final, Strasbourg, October 25, 2016.
 - 17 See OECD/G20, *Action Plan on Base Erosion and Profit Shifting*, Paris, July 2013. Also see *Inclusive Framework on BEPS: Progress Report July 2018- May 2019*, Paris, 2019.
 - 18 See OECD/G20, *Addressing the Tax challenges of the digital economy. Action 1. 2015 Final Report*, Paris, October 2015; *Interim Report on the Tax challenges arising from digitalisation*, Paris, March 2018; *Programme of work to develop a consensus solution to the tax challenges arising from the digitalisation of the Economy. Inclusive framework on BEPS*, Paris, May 2019.
 - 19 See OECD/G20, *Preventing the artificial avoidance of Permanent Establishment Status. Action 7. 2015 Final Report*, Paris, October 2015; *Additional Guidance of the attribution of profits to a Permanent Establishment under BEPS Action 7*, Paris, March 2018.
 - 20 See OECD/G20, Base Erosion and Profit Shifting Project, *Interim Report on the Tax challenges arising from digitalisation*, Paris, March 2018.
 - 21 See PINTO, D. «Options to address the direct tax challenges raised by the digital economy. A critical analysis», *Canadian Tax Journal/Revue Fiscale Canadienne*, 2017, issue 65:2, pp. 304.

Despite above, in absence of consensus²², the Report of 2018 (labelled «interim»²³ and based on the 2015 «final» Report) does not choose to launch any action. At that moment, the situation was the following: (1) Around 110 members of the inclusive framework recognized their common interest in *maintaining* a relevant and coherent set of international tax rules; (2) There was sufficient support to carry out a coherent review of two key aspects of the current fiscal framework: the nexus and the rules for the allocation of benefits; (3) There was not accord on the merits of, *or need for*, to adopt interim measures; and (4) Some members believed that the proliferation of unilateral –rather than multilateral– approaches would have adverse impacts on the investment and growth, and ran the risk of increasing double taxation and complexity for taxpayers and tax authorities.

Shortly after, the IF (Inclusive Framework) accepted to review the proposal by grouping it into a couple of blocks (pillar one and two) in the hope of achieve a consensus solution. This was the standpoint of more than one hundred countries (137 in 2019) regionally distributed as follow: Africa (18%), Asia-Pacific (15%), Western Europe (22%), Eastern Europe-Central Asia (19%) and North America, Latin America, and Caribbean (26%)²⁴. Finally, on October 2020, the IF was approved the Blueprints on Pillar one (focused on new nexus and rules for the allocation of benefits with the objective that tax rights on corporate profits they were no longer confined exclusively to the physical presence) and

-
- 22 According to the 2018 Interim Report: «There is no consensus on either the merit or need for interim measures with a number of countries opposed to such measures on the basis that they give rise to risks and adverse consequences irrespective of their design. Other countries acknowledge these challenges but consider that they do not outweigh the need to implement interim measures and consider that at least some of the possible adverse consequences can be mitigated through the design of the measure. Countries in favour of the introduction of interim measures have set out guidance on the design considerations that need to be taken when considering the introduction of such measures». See OECD/G20, *Base Erosion and Profit Shifting Project. Interim Report on the Tax challenges arising from digitalisation* footnote 20, pp 178.
- 23 See OECD/G20, Base Erosion and Profit Shifting Project, *Interim Report on the Tax challenges* footnote n° 20.
- 24 See OECD/G20, *Inclusive Framework on BEPS, Progress Report July 2019-July 2020*, Paris, 2020, pp 9.

In recent years, many multilateral Organizations have published different proposals to face the challenges arising by the digitization, especially from a tax perspective. Undoubtedly, the work accomplished by the OECD with the support of the G20 and the Inclusive Framework (141 countries and jurisdictions) constitutes the central axis of the current international debate on this matter although also, obviously, the remarkable work carried out by the European Union.

Taxes on the digital economy can take a variety of forms. Some are as simple as consumption taxes on internet purchases or on services such as eNewspapers subscriptions. Instead, other proposals seek to collect taxes generated by the new business models and, to some extent, separate the tax treatment of digital companies from other parts of the economy. Thus, the first part of this book focuses on the meaning, taxonomy, and boundaries of the digital economy.

The second part aims to address some technical concepts that have very relevant tax consequences such as the notion of automated digital services or the consumer-facing businesses. The purpose is to provide an overview of which activities will be taxed, which are likely to be excluded, how to identify them and what indicators will be used. Finally, in the third part, we briefly explain how the revenue sourcing rules will be determined in each business model according to the most recent OECD proposal.



SILVIA VELARDE ARAMAYO

Mrs. Silvia Velarde Aramayo has a degree and a Doctorate in Law from the University of Salamanca, where she is currently Professor of Tax Law at the Faculty of Economic and Business. She has completed her academic training at both Harvard University and Boston College Law School.

In addition, is the author of several monographs and articles in specialized Law Reviews and has been a visiting researcher in different European Universities.

As Professor of Tax Law, she teaches in many Degrees and Masters in Spain and in foreign Universities.

PVP 15,00 €

ISBN: 978-84-1359-379-1



9 788413 593791