TAX JUSTICE NETWORK AFRICA

TAXATION OF THE DIGITAL ECONOMY: CHALLENGES AND OPPORTUNITIES

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Summary

1. Context
2. Use of digital goods / services
3. Taxing Digital Economy
4. Marketing Intangibles
5. Significant Economic Presence
6. Opportunities
7. Group Exercise

CONTEXT

1

4TH INDUSTRIAL REVOLUTION

The world is moving towards technology as a basis for interaction and doing business. New technologies such at blockchain and e-services.

2

THE RISE OF DIGITAL BUSINESSES

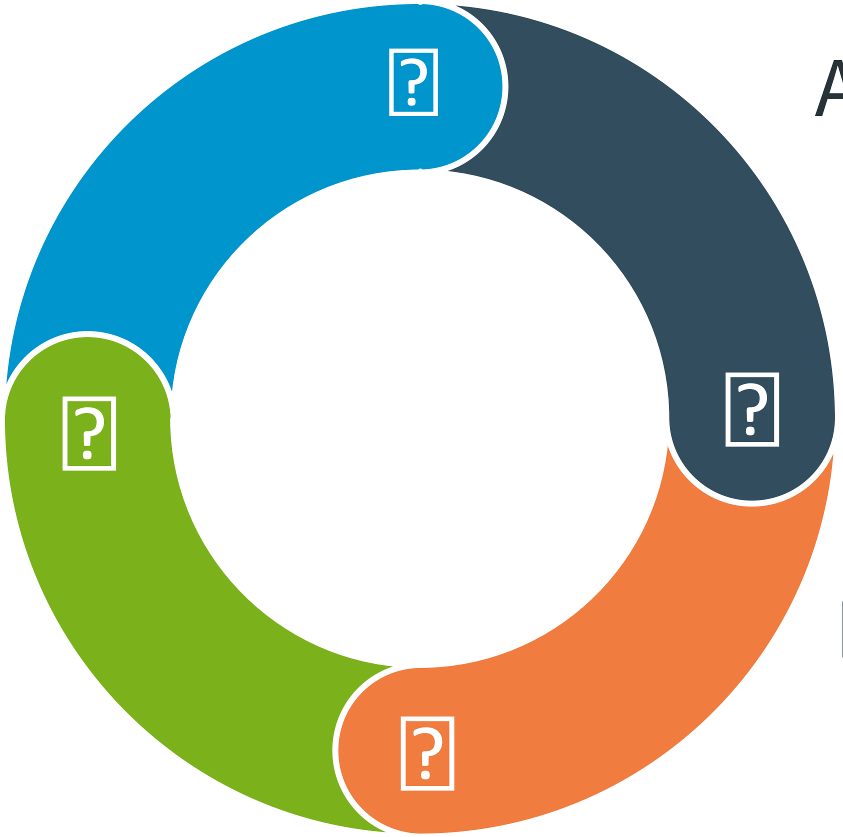
Digital business are effective to operate and maximise profit with limited balance sheet assets

3

THE WORLD IS MOVING ON

Changes to traditional norms of doing business and living standards are hinged on convenience and easy access to information

WHICH OPERATORS DO AFRICANS USE?



Apple iOS – 6,06%

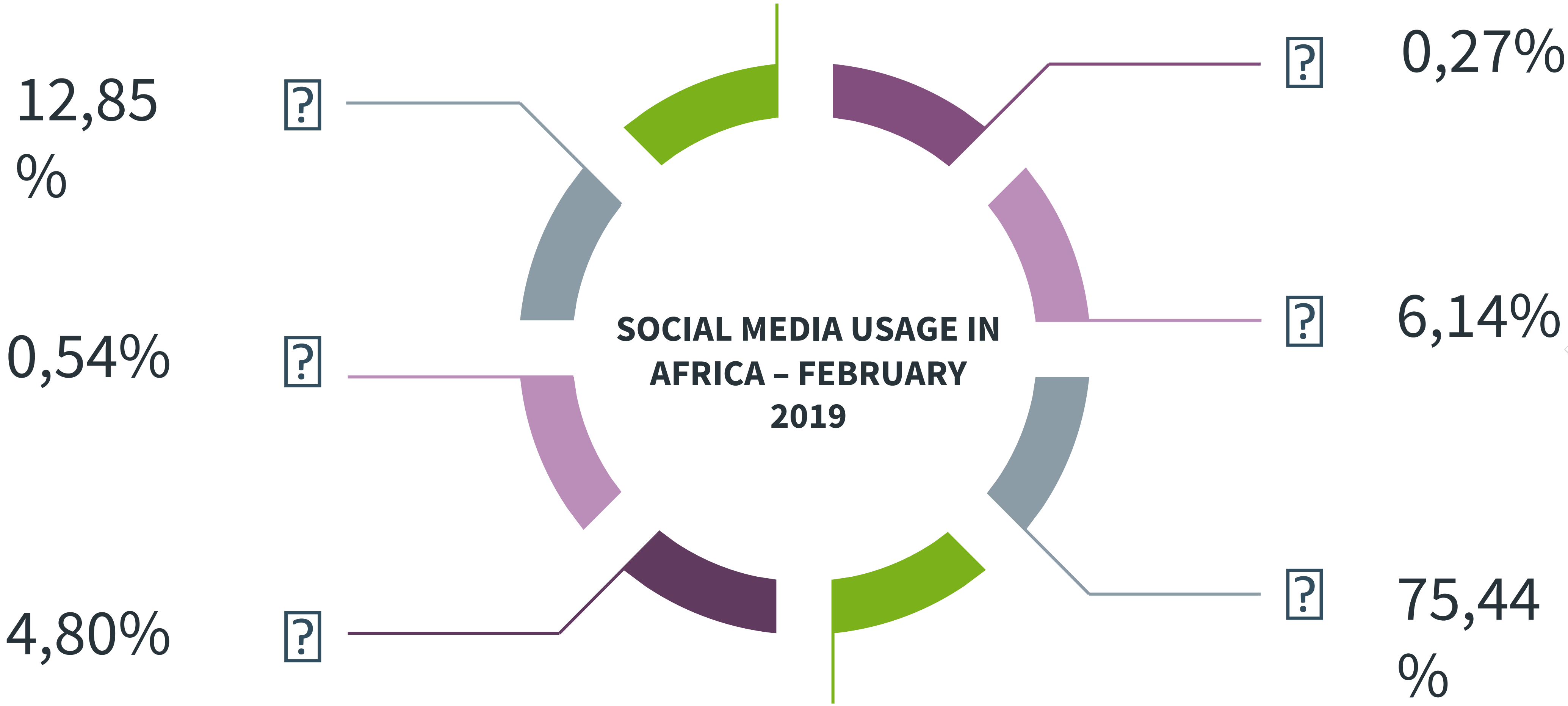
Android – 45,69%

Windows – 32,73%

Linux – 0,58%

Source: Global Stats – Stats Counter

WHICH SOCIAL MEDIA PLATFORM DO WE USE MOST?



Source: Global Stats – Stats Counter

HIGHLY DIGITALISED BUSINESSES

Amazon USD107.01Bn	eBay USD85.92Bn		Overstock USD1.66Bn	Alibaba USD394Bn	JD.com USD64.6Bn	Dangdang USD1.48Bn
Facebook USD17.9Bn	Google USD74.54Bn	Linkedin USD2.99Bn	Yahoo USD4.97Bn	Tencent USD15.82Bn	Baidu USD10.51Bn	Soufun USD883.51Mn
Trip Advisor USD1.49Bn	Expedia USD6.7Bn		Uber USD10Bn*	Qunar USD643.9Mn	Ctrip USD1.82Bn	Didi Kuaidi USD12Bn*

- Digital business have risen and **effectively replacing traditional business**
  - Uber vs meter taxi
  - AirBnb vs Guesthouse
  - Booking.com vs Hotel
  - Expedia vs Travel Agent
  - Amazon vs postal service
  - LinkedIn vs Labour broker
  - Alibaba vs marketplace
- Most of these businesses **don't have physical presence**
- They don't have to be in your country to supply the service (Netflix)

THE CHALLENGE TO TRADITIONAL TAX RULES

- US Company – Service is available in South Africa for $10 per month
- Download the app and stream content on your phone or smart TV or download content to watch later
- 4 users allowed on your profile – possibly stream from different part of the country
- Where should the company be taxed? In the USA or in South Africa?

WHAT IS THE CHALLENGE/PROBLEM?

- The digitalisation of the economy and other technological advances have enabled **business enterprises to be heavily involved in the economic life of a jurisdiction without a significant physical presence.**

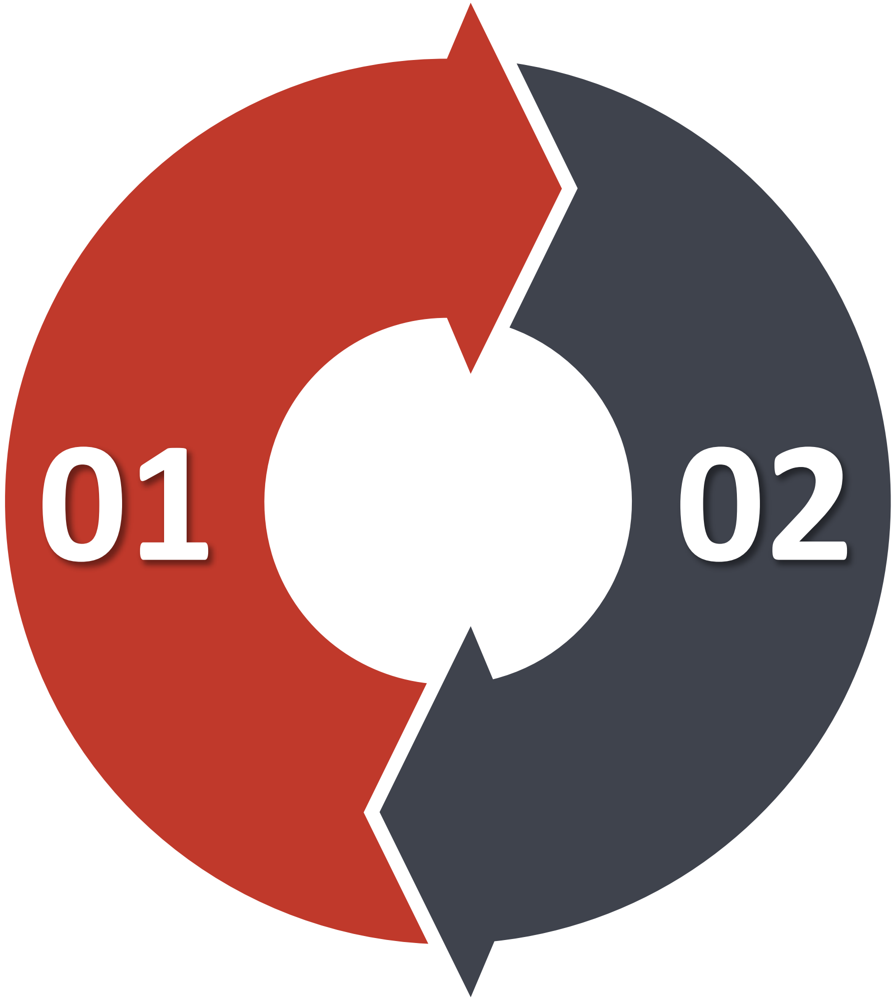
- These technological advances have rendered the existing nexus and profit allocation rules ineffective.

This results in a revisit of 2 fundamental rules in international taxation

NEXUS & PROFIT ALLOCATION

NEXUS RULES

determines whether jurisdiction **has taxing rights over a non-resident and usually requires the non-resident to have a physical presence** in that jurisdiction to create such a taxing right and



PROFIT ALLOCATION

which determine how the **MNE's global profits are allocated between jurisdictions,** primarily through transfer pricing rules.

WHAT IS ON THE CARDS FOR THE WORLD?

Digitalisation raises the question of h**ow taxing rights** on income generated from **cross border transactions should be allocated between jurisdictions**.

The **allocation of taxing rights between residence and source jurisdictions has been an issue of considerable concern for African countries** for many years. African countries are generally source countries and tax on a source basis.

THE 3 MAIN PROPOSALS

Marketing intangibles

Advanced by the US
Gives taxing rights to market jurisdictions (Africa)
Proposes some formulas in profit allocation

Significant Economic Presence

Advanced by G-24 (India)
Gives taxing rights to source countries
Proposes a formula

Anti-Base Erosion

Advanced by France and Germany
Essentially addresses what BEPS has not addressed

PILLAR 1 – MI & SEP

MARKETING INTANGIBLES	SIGNIFICANT ECONOMIC PRESENCE
Proposed by the USA	Proposed by India and G-24
Allocating more taxing rights to market jurisdictions	Allocating more taxing rights to market jurisdictions
Changes to nexus and profit allocation rules including right of source countries to tax non-residents on their business profits	Widening the scope of P/E to allow source countries to tax non-residents on their business profits
There will be a mix between applying the existing current TP rules for routine profit (debating) approach would modify current transfer pricing and treaty rules through **revised profit allocation rules**	Allocation of profit to a significant economic presence could be based on a **fractional apportionment method**
Not ring-fenced to digitalised businesses → will apply to both digital and traditional businesses	Largely focussing on digitalised businesses (establishing a virtual PE)

MARKETING INTANGIBLES

CUSTOMER DATA

Information kept about the customer. This also related to customer relations that a company may have developed to specialize the service

INTANGIBLES

These are created in the market jurisdiction

TARGETING CUSTOMERS

Think of a Facebook advertisement or how after search “holiday in France”, you then get ads for accommodation in France

INTANGIBLES

risks associated with such intangibles to be allocated to the market jurisdiction.

This approach would give the market jurisdictions a right to tax highly digitalised businesses

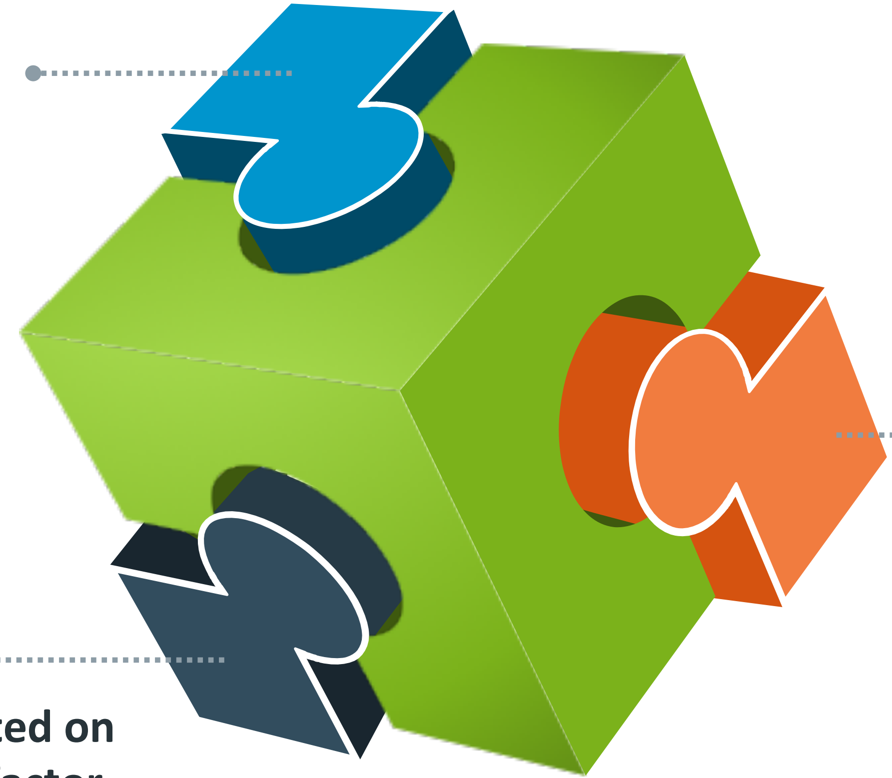
Even in the absence of a taxable presence → Given the importance of market intangibles for such business models.

MARKETING INTANGIBLES – ISSUES TO CONSIDER

- Do we agree with the marketing intangible proposal that there is an intrinsic factual link between a market jurisdiction and marketing intangibles related to that jurisdiction.
- Should the loyalty of an active and engaged user itself be considered a type of marketing intangible.
- Its premise is that this intrinsic link justifies the reallocation of profits of relevant businesses to countries in which customers are located,
- or rather being awarded taxing rights over some portion of profits attributable to marketing intangibles

SIGNIFICANT ECONOMIC PRESENCE

A taxable presence in a jurisdiction would arise when a non-resident enterprise has a significant economic presence on the basis of factors that evidence a purposeful and sustained interaction with the jurisdiction via digital technology and other automated means



This would be revenue generated on a sustained basis is the basic factor, but such revenue would not be sufficient in isolation to establish nexus.

Only when combined with other factors would revenue potentially be used to establish nexus in the form of a significant economic presence in the country concerned.

SIGNIFICANT ECONOMIC PRESENCE

1. The existence of a user base and the associated data input;
2. The volume of digital content derived from the jurisdiction;
3. Billing and collection in local currency or with a local form of payment;
4. The maintenance of a website in a local language.
5. The responsibility for the final delivery of goods to customers or the provision by the enterprise of other support services such as after-sales service or repairs and maintenance; or
6. Sustained marketing and sales promotion activities, either online or otherwise, to attract customers

SEP – FRACTIONAL APPORTIONMENT

- A fractional apportionment method would require the performance of three successive steps:

1. the definition of the tax base to be divided,
2. the determination of the allocation keys to divide that tax base,
3. and the weighting of these allocation keys.

OPPORTUNITIES

ALLOCATION OF TAXING RIGHTS

African countries stand a better chance of inning the debate on taxing rights.

REDIFINED NEXUS RULES

A new take of the nexus rules is most likely to happen and this may lead to simplification of complexities

FORMULAIC APPROACHES

The use of formulas as a means of allocating profits or determining the profits of MNEs is a reality and possibility

Africa will benefit

Given the need to allocate taxes to source countries and the current drafting phase, African countries stand a good chance of making positive impact.

BEPS 2.0

There is an opportunity to address the areas that BEPS failed to address

Tax Incentives

The Pillar 2 proposal will have an effect on tax incentives, which will finally give African countries food for though before granting tax incentives.

GROUP EXCERCISE

THANKS FOR YOUR ATTENTION !!!