

Tax Analysis

For more information, please contact:

International Tax Services
National leader/Eastern China
Shanghai
Vicky Wang
Partner
Tel: +86 21 6141 1035
Email: vicwang@deloitte.com.cn

Northern China
Beijing
Jennifer Zhang
Partner
Tel: +86 10 8520 7638
Email: jenzhang@deloitte.com.cn

Southern China
Hong Kong
Sharon Lam
Partner
Tel: +852 2852 6536
Email: shalam@deloitte.com.hk

BEPS Action 1: Tax challenges of the digital economy

Introduction

The OECD released a discussion draft on 24 March 2014 as part of its work on Base Erosion and Profit Shifting (BEPS). The discussion draft includes proposals for Action 1 (Tax challenges of the digital economy) of the BEPS Action Plan. The Action Plan identifies changes in business as a result of the digital economy as one of the main threats to base erosion.

The draft proposals set out in the document do not represent the consensus views of either the Committee of Fiscal Affairs or its subsidiary bodies, but are intended to provide stakeholders with substantive proposals for comment.

Proposals

Action 1 calls for the OECD to:

“Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location relevant data through the use of digital products and services, the characterisation of income derived from new business models, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services”.

The draft is divided into four main areas of discussion:

- Background on the digital economy,
- Perceived opportunities for BEPS within the digital economy,
- Ways of addressing BEPS with respect to the digital economy (which largely focuses on the manner in which the other action items will address such concerns), and
- A discussion of the potential options to address the broader tax challenges raised by the digital economy.

The proposed options discussed in the draft are:

1. Amendments to the permanent establishment definition,
2. Withholdings taxes on digital transactions, and
3. Consumption tax (VAT) options.

Amendments to the Permanent Establishment (PE) Definition

a) Modifications to the Preparatory and Auxiliary Exception

The preparatory and auxiliary exception would be modified or eliminated. The first option would eliminate the exception for preparatory and auxiliary activities for "certain businesses" where the following activities constitute core functions of the business:

- The use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
- The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
- The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
- The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise.

These "certain businesses" are not defined, just as the "digital economy" is undefined in the draft, but could catch some very well publicised business models.

Variations on the option are also discussed, including elimination of the preparatory and auxiliary activities exception entirely.

b) Defining Permanent Establishment to mean Significant Digital Presence

This option would provide that if an enterprise is engaged in certain "fully dematerialised digital activities" then it could have a permanent establishment if it maintained a "significant digital presence" in the economy of another country. If an enterprise was engaged in a fully dematerialised digital business, a permanent establishment would be deemed to exist if the business maintained a "significant digital presence".

c) Virtual Permanent Establishment

The draft also reproduces a few options for alternative permanent establishment standards that have been discussed previously including a "virtual fixed place of business PE", a "virtual agency PE" and an "on-site business presence PE".

Withholding Tax on Digital Transactions

This option would impose a withholding tax on certain payments made by residents of a country for digital goods or services provided by a foreign e-commerce provider.

Consumption Tax Options

With regard to the application of VAT to digital transactions, the discussion draft outlines two options. The first is to reduce or eliminate the generally available exemptions for imports of low valued goods. The second option would require a non-resident supplier to register and account for the VAT on supplies sold in the jurisdiction of the consumer. The compliance burden involved would be significant.

Timetable and Next Steps

Comments were requested by 7 April 2014 given the extremely tight timetable for the BEPS project. A public consultation event was held in Paris on 23 April 2014 before the proposals are finalised in September 2014. Adoption of the final proposals will need to await the multilateral convention (Action 15 – due December 2015), as individual negotiation will be time-consuming.

Deloitte comments

Tackling the fast-moving digital economy presents an enormous challenge to tax authorities around the world, making it probably the hardest issue faced by the OECD. The OECD is clear that "structures aimed at artificially shifting profits to locations where they are taxed at more favourable rates, or not taxed at all, will be rendered ineffective by ongoing work in the context of the BEPS project". There are no proposals for new digital taxes, however the draft seems to imply that unilateral approaches may be considered should the preferred multilateral solutions fail to reach consensus.

Note: Contents discussed in this Tax Analysis pertain to Deloitte International Tax Services

Tax Analysis is published for the clients and professionals of the Hong Kong and Chinese Mainland offices of Deloitte China. The contents are of a general nature only. Readers are advised to consult their tax advisors before acting on any information contained in this newsletter. For more information or advice on the above subject or analysis of other tax issues, please contact:

Beijing

Kevin Ng
Partner
Tel: +86 10 8520 7501
Fax: +86 10 8518 7501
Email: kevnng@deloitte.com.cn

Hong Kong

Sarah Chin
Partner
Tel: +852 2852 6440
Fax: +852 2520 6205
Email: sachin@deloitte.com.hk

Shenzhen

Constant Tse
Partner
Tel: +86 755 3353 8777
Fax: +86 755 8246 3222
Email: contse@deloitte.com.cn

Chongqing

Kevin Ng
Partner
Tel: +86 23 6310 6206
Fax: +86 23 6310 6170
Email: kevnng@deloitte.com.cn

Jinan

Eunice Kuo
Partner
Tel: +86 531 8518 1058
Fax: +86 531 8518 1068
Email: eunicekuo@deloitte.com.cn

Suzhou

Frank Xu / Maria Liang
Partner
Tel: +86 512 6289 1318 / 1328
Fax: +86 512 6762 3338
Email: frakxu@deloitte.com.cn
mliang@deloitte.com.cn

Dalian

Frank Tang
Partner
Tel: +86 411 8371 2888
Fax: +86 411 8360 3297
Email: ftang@deloitte.com.cn

Macau

Quin Va
Partner
Tel: +853 8898 8833
Fax: +853 2871 3033
Email: quiva@deloitte.com.hk

Tianjin

Jason Wu
Partner
Tel: +86 22 2320 6680
Fax: +86 22 2320 6699
Email: jassu@deloitte.com.cn

Guangzhou

Constant Tse
Partner
Tel: +86 20 8396 9228
Fax: +86 20 3888 0121
Email: contse@deloitte.com.cn

Nanjing

Frank Xu
Partner
Tel: +86 25 5791 5208
Fax: +86 25 8691 8776
Email: frakxu@deloitte.com.cn

Wuhan

Justin Zhu
Partner
Tel: +86 27 8526 6618
Fax: +86 27 8526 7032
Email: juszhu@deloitte.com.cn

Hangzhou

Qiang Lu
Partner
Tel: +86 571 2811 1901
Fax: +86 571 2811 1904
Email: qilu@deloitte.com.cn

Shanghai

Eunice Kuo
Partner
Tel: +86 21 6141 1308
Fax: +86 21 6335 0003
Email: eunicekuo@deloitte.com.cn

Xiamen

Lynch Jiang
Partner
Tel: +86 592 2107 298
Fax: +86 592 2107 259
Email: ljiang@deloitte.com.cn

About the Deloitte China National Tax Technical Centre

The Deloitte China National Tax Technical Centre ("NTC") was established in 2006 to continuously improve the quality of Deloitte China's tax services, to better serve the clients, and to help Deloitte China's tax team excel. The Deloitte China NTC prepares and publishes "Tax Analysis", "Tax News", etc. These publications include introduction and commentaries on newly issued tax legislations, regulations and circulars from technical perspectives. The Deloitte China NTC also conducts research studies and analysis and provides professional opinions on ambiguous and complex issues. For more information, please contact:

National Tax Technical Centre

Email: ntc@deloitte.com.cn

National Leader

Leonard Khaw
Partner
Tel: +86 21 6141 1498
Fax: +86 21 6335 0003
Email: lkhaw@deloitte.com.cn

Northern China

Julie Zhang
Partner
Tel: +86 10 8520 7511
Fax: +86 10 8518 1326
Email: juliezhang@deloitte.com.cn

Southern China (Hong Kong)

Davy Yun
Partner
Tel: +852 2852 6538
Fax: +852 2520 6205
Email: dyun@deloitte.com.hk

Southern China (Mainland/Macau)

German Cheung
Director
Tel: +86 20 2831 1369
Fax: +86 20 3888 0121
Email: gercheung@deloitte.com.cn

Eastern China

Kevin Zhu
Director
Tel: +86 21 6141 1262
Fax: +86 21 6335 0003
Email: kzhu@deloitte.com.cn

If you prefer to receive future issues by soft copy or update us with your new correspondence details, please notify Wandy Luk by either email at wanluk@deloitte.com.hk or by fax to +852 2541 1911.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/cn/en/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte has in the region of 200,000 professionals, all committed to becoming the standard of excellence.

About Deloitte in Greater China

We are one of the leading professional services providers with 22 offices in Beijing, Hong Kong, Shanghai, Taipei, Chengdu, Chongqing, Dalian, Guangzhou, Hangzhou, Harbin, Hsinchu, Jinan, Kaohsiung, Macau, Nanjing, Shenzhen, Suzhou, Taichung, Tainan, Tianjin, Wuhan and Xiamen in Greater China. We have nearly 13,500 people working on a collaborative basis to serve clients, subject to local applicable laws.

About Deloitte China

The Deloitte brand first came to China in 1917 when a Deloitte office was opened in Shanghai. Now the Deloitte China network of firms, backed by the global Deloitte network, deliver a full range of audit, tax, consulting and financial advisory services to local, multinational and growth enterprise clients in China. We have considerable experience in China and have been a significant contributor to the development of China's accounting standards, taxation system and local professional accountants.

This publication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively the "Deloitte Network") is by means of this publication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this publication.