If the future is digital, is Transfer Pricing stuck in the past?
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Agenda

01 Digitalization of the economy and transfer pricing
02 OECD Interim Report
03 EU Commission proposal
04 HMRC position paper
05 Conclusions
OECD 2018 interim report

DE tax concerns
- Nexus – exploitation without traditional nexus
- Data – how to attribute value
- Characterization – digital revenues

User value creation
- No consensus
- Concerns include user data, use of infrastructure, and base erosion

Long-term solution
- No consensus
- Nexus – jurisdiction to tax nonresidents
- Profit allocation – how to allocate profits to jurisdictions

Interim measures
- No consensus
- No recommendations
- Framework agreed as to design of interim measures
Both long-term and interim measures raise a number of design and implementation issues. Consensus on these considerations will be difficult and time consuming.

**International obligations**
- How do you design a digital tax consistent with treaty obligations?
- What are the potential implications?

**Transfer pricing**
- Consistent with the arm’s-length principle?
- Challenges with a “modified” authorized OECD approach (AOA)
- The “U.K. approach”

**Design considerations**
- Party to tax
- Sourcing profits and revenue
- Assessment and collection

**Scope concerns**
- How to define what’s in and what’s not?
- Flexibility for future DE business models
Big picture and looking forward

Could these proposals really become reality, and what could it mean to international tax norms?

— What is this debate really about?
— Is consensus possible for a long-term solution that singles out the DE possible?
— Are there broader trade implications?
— Where will we be in the future (one year out? five years out?)
EU proposals from 21 March

Targeted (interim) proposal: directive on digital service tax
— Companies that derive revenues from certain digital services in EU countries
— 3% of gross revenues on certain digital services
— Combined threshold:

Total (group) revenue > 750mEUR/financial year

Revenue from digital services > 50mEUR/financial year

— Expected to remain in force until the renegotiation of DTT with non EU countries

Comprehensive proposal: directive on digital PE
— Taxpayers in the EU and from non-EU countries but w/o DTT
— Introduction of taxable nexus in case of significant digital presence
— Wider definition of digital services than under the DST
— Not applicable where a double tax treaty with the relevant MS applies

Both proposals shall be effective from 1 January 2020 – unanimity required

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EU digital permanent establishment

— New taxing rules if one of the following thresholds per a Member State is met

Revenues from supplying digital services > €7 million
Number of users > 100k
Number of online business contracts > 3k

— Digital service → service delivered over the internet or an electronic network, the nature of which renders its supply essentially automated and involving minimal human intervention

— The authorized OECD approach remains the underlying principle for profit attribution, BUT

— Analysis of significant people functions is not sufficient, as it does not reflect the value creation

— Attribution of profits shall take into the account the economic significant activities which are relevant for the development, enhancement, maintenance, protection and exploitation of intangible assets

— Profit split method is preferred unless the taxpayer shows that another method is more appropriate

— Possible splitting factors: R&D expenses, the number of users and data collected
HM Treasury’s Updated Position Paper

UK supports the notion that business profits should be taxed in the jurisdiction where value is created

— Business centralization and remote selling don’t, *per se*, undermine this principle
— This principle is challenged when user participation/engagement contributes to value creation
  - UK distinguishes between user participation and traditional customer role; the former involves what are traditionally supply side functions (i.e. creation of content)
  - Collecting data doesn’t meet the threshold for user value creation

Proposal for Long Term Reform

— Re-allocate a portion of profits from Principal (residual profit recipient) to country where user-generated value is created in two-step process
  1. Allocate a share of residual profits to user-generated value
  2. Apportion a share of user-generated value to specific jurisdiction (e.g. UK)

Interim Measure

— Tax on revenues of certain digital businesses that derive significant value from UK user participation
Key Points to Take Away
Thank you

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