



Tuesday, September 4

Plenary Session Subject : Withholding tax in the era of BEPS, CIVs and digital economy

General Reporter: Prof. Chang Hee Lee (Republic of Korea), Prof. Ji-Hyun Yoon (Republic of Korea)

Chair: Paul Morton (UK)

Panel Speakers: Gary Sprague (Baker & McKenzie LLP, USA), Valère Moutarlier (European Commission), Bill Sample (Microsoft, USA), Prof. Jinyan Li (Osgoode Hall Law School, Canada)

Secretary: Jiwon Park (Kim & Chang, Republic of Korea)

Mr. Paul Morton opened the Panel by commenting that the topic of withholding tax has been taken for the first time as a main plenary topic at the IFA Congress. The Panel kicked off the discussion by raising an interesting question about why withholding tax has not evolved along with advancement in technology and wondering why it did not form part of the BEPS Project. The Panel then gave a brief review of the General Report, highlighting that some of the main issues are that withholding tax is not applied by each country in the same way, the debate on PE vs. withholding tax and concerns with withholding agents as it also deals with taxpayer's rights.



The Panel then touched upon the Canadian perspective on withholding tax applicability of Canadian sourced income. It was explained that there are 2 categories – one, withholding tax as a final liability (gross amount) which is applicable on payments like rent, royalty, dividend etc. The other category is provisional tax (variable rates) applicable on service income (employment, business, etc.) and capital gains. Based on branch reports, it was observed that many countries follow similar system of gross and provisional withholding tax.

Stating that withholding tax applicability is linked to “source” of income and source rules play a critical role in withholding tax determination, **Mr. Gary Sprague** explained that source rules have evolved and the concept of providing market akin to source has potential to create issues. Thereafter, highlighting the 2 concepts of withholding tax as a proxy for net income tax –



withholding mechanism (e.g. payroll taxes) versus gross based tax (digital economy), it was stated that gross based tax creates high percentage of net income to gross income. Further, it was explained that dividend and interest meet high percentage of net income to gross income test but in case of royalty or services, there is no particular connection between income and payment. Also there are many other taxes on gross payments which act as proxy e.g. excise tax, equalisation levy, gross receipt taxes on business or tax on import of foreign content.



Referring to OECD’s Interim Report on Digital Economy, in which withholding tax hardly finds a mention; the Panel raised a pertinent question about why withholding taxes were not seen as a key part of the digital economy discussion? In this regard, **Mr. Bill Sample** stated that he was not surprised that withholding taxes were not part of OECD’s BEPS Project. He highlighted that UN, on the other hand, has proposed new article which

proposes taxes on range of services.

Regarding the EU Package, it was stated that digital sales is at the center point of the political momentum in EU policies, urged by citizen driven discussion. It was also explained that EU Package has a comprehensive and interim solution - comprehensive taxation comprising of the digital presence directive which will be integrated into CCCTB, based on the premise of a ‘single market’ approach and interim solution of turnover tax on three service categories - advertising, intermediation and sale of user data. Further, it was remarked that *“Digital Service Tax is not paid by a user, customer or a third party! It is a tax charge on gross revenues from certain e-services. It’s a new tax and not a WHT.”* As regards comprehensive solution, it was clarified that new nexus rules are being proposed based on users, contracts or revenue and transfer pricing analysis will be adopted to allocate profits.



Mr. Bill Sample commented that EU has accelerated the process and it is driven by politics. He, however, cautioned that gross receipt based tax even at low rates would result in higher prices.



He mentioned that even a low 3% digital service tax (DST) translates to 80% tax on median profit at the rate of 15% of income. Mr. Garry Sprague added that DST is not proxy for income tax, it's applicable to profit as well as loss making companies. He added that it would be more appropriate to consider DST as akin to excise tax or tax to access market or extraction tax payable by oil companies.

Thereafter, the Panel discussed UK's Position Paper, which provides that Profits of a business should be taxed in the country in which value is created.

Regarding the policy rationale for imposing withholding tax if it was justified as a proxy for a net income tax, it was stated that the critical discussion would be over concepts of source like Deployment of property or activity in the state, Government benefits provided to supplier, imbalance in provision of high value services, local "base erosion" alone and location of users or customers. Thereafter, it was highlighted that possible ways to ameliorate distortions of a gross-based income tax are option to file net income tax return, changed PE thresholds, leading to direct net income tax liability, variable WHT rates by category of income and variable WHT rates by profitability of company. The Panel then gave examples of varying withholding tax rates e.g. cultural royalty vs. technology royalty and also cited the example of Taiwan which levies tax on digital services based on two rates. However, the Panel highlighted that they haven't seen practical examples of withholding tax rates based on profitability. The Panel also explained that the most recent proposals for WHT on active business income were technical services, software payments, digital services and B2C content.

Majority of the audience answered yes to the question whether withholding tax can be the answer to the challenges of the digitalized economy?

Dealing with the concept of collective investment vehicle (CIVs), on the key question as to how an international investor can recover multiple layers of withholding tax, Chair Mr. Paul Morton explained that technology in banking world may allow tagging withholding tax to the investor. Further, in EU, while the situation is complicated, and impact is heavy, it was highlighted that EU work on simplifying withholding tax regime has been initiated.





Finally, on the question whether we can reimagine withholding tax based on net income, Chair Mr. Paul Morton stated that use of technology could be considered in the future.

D T S & Associates
Chartered Accountants

DTS & Associates Take:

By Mr. T. P. Ostwal (Partner, DTS & Associates)

The question of withholding tax under the treaty was not discussed so far because treaties don't address withholding tax. They give you taxing rights, either limited taxing right or full taxing right, which is there in the tax treaty. The issue which was raised in the panel and as rightly said by the Chair of the panel that it was debated for the first time. Because of the digital economy and the availability of the technology, one should develop the technology and take advantage of the withholding tax so that it becomes transparent, the leakage is avoided and everything will be collected and known to everybody. Through exchange of information, one can also get the information of other countries, so availing the credit is also not difficult. It was very interesting learning session and the number of issues raised were eye openers for the general participants.

Avoided PE is an issue because people are avoiding PEs by circumventing number of criteria and thresholds. Therefore, question is by virtue of these, whether PE withholding can also be avoided and there should be safeguards and checks and balances.

By Mr. Kuntal Dave (Partner, DTS & Associates)

The panel gave very broad and at the same time a very important outcome that this is going to be very challenging and the most debated concept and the challenge is on how do we get consensus over the subjects. Talking about the user data and the valuation attached with the user data, we can already see the headwinds on that. There are few examples like Master Card decision where the authorities were examining the significance of cost of MIP, while deciding on the concept of PE. They have mentioned that it is very important to examine the place where the server is located and the data resting on the server, especially the time when that data or information is sold. Hence going forward, when there is a commercial exploitation of say user data or any information which is resting on the server outside India, we can expect some new ways of taxing the same in India. There is already an awareness among the Revenue officers and the tax-policy makers about the issue and they really need to ensure that they are not left behind in this debate and they want to have their right of share also.



Seminar C: Limits of tax jurisdiction - non-traditional "business presence"

Chair: Richard Vann (Australia)

Panel Speakers: D.P. Sengupta (India), Sophie Chatel (OECD), Conrad Turley (Ireland/PRC), Liz Chien (USA)

Secretary: Soojin Lee (IBFD)

The panel discussed the issues surrounding the virtual PE and debated on whether the international tax rules should be modified to deal with digitalisation on a long-term basis. The panel discussed the following key propositions:

- Whether a company not having physical presence in a country be taxed if it effects transactions with customers in that country by digital means and has substantial market share in the digital space for the kind of platform involved?
- Whether the threshold for taxing in no-physical-presence cases should be based on a combination of factors involving a monetary threshold, 'clicks' threshold and a measure of market share?
- Approach in allocation of profit derived from digital sales to customers in a country.



The panel discussed need for 'nexus' rule and the 3 approaches of creating nexus for a non-resident viz. a) **revenue based** depending upon level of involvement in the economic life b) **users or clicks based** approach based on integration of user base into enterprise value creation processes; and c) **investment approach** based on return on capital.

Responding to a poll on the question that *"If a company does not have a physical presence in a country it should be taxed if it effects transactions with customers in*

that country by digital means and has substantial market share in the digital space for the kind of platform involved", majority in the audience voted as 'yes'.

Ms. Sophie Chatel, Head of Tax Treaties at OECD mentioned about OECD's engagement involving 100+ countries. She mentioned that new thresholds and new profit allocation are the two important considerations in OECD's current work. She added that the work is politically challenging but added that *"it is important to get it right"*. She also mentioned that unilateral



measures taken by the countries remains a big concern. She therefore stated that the priority is to reach a consensus. She added that while taxing the local entities (in the context of highly digitalised businesses), Article 9 could be a challenge and in case of non-residents, Article 7 needs to be addressed. She stated that “*if new taxing right is allocated to market or source country, the issue is not over, but the difficulty starts*”. Ms. Chatel commented that it leads to double taxation and hence needs to be eliminated (e.g. via tax credit or tax adjustment).

Mr. D.P. Sengupta (Former Indian Revenue Services) explained India’s equalisation levy and significant economic presence test. He set the context that compared to OECD countries, India has a very low tax-GDP ratio, corporate tax contributing higher percentage of tax revenues and a very low per capital GDP.