International ambitions

Indirect Tax



01 June 2020

With the uncertainties plaguing the technology, media and telecommunications sector, *David Latief, Liam Smith* and *Tiffany Vaughan* ask if there has ever been a more challenging time for an indirect tax function

Key Points

What is the issue?

Businesses in the TMT sector are facing more challenges than ever right now, with the introduction of DSTs globally and the expansion of existing indirect tax regimes, which come at a time of wider economic and political uncertainty due to Brexit and the Covid-19 pandemic.

What does it mean for me?

Businesses must continuously monitor global tax developments to ensure they are complying with their VAT obligations, which can be both a costly and time-intensive exercise, not only in terms of tax compliance, but also from a systems and process perspective.

What can I take away?

As global tax policymakers seek new ways to tax the digital economy, businesses will have to continue to adapt and factor new digital tax policies into their wider business strategy.

Businesses within the technology, media and telecommunications (TMT) sector are at the forefront of driving the development and innovation taking place within the digital economy. The reaction of tax authorities to these developments is having a profound effect on the global indirect tax landscape, as tax policymakers seek to redefine global taxation principles that were first devised years before the inception of many of the companies that are leading the disruption taking place in the sector.

The pace and level of change to the international tax framework that businesses are faced with has never been greater. With the ever-expanding scope of existing indirect tax regimes and the introduction of new digital services taxes (DSTs), businesses are facing increased challenges in monitoring and complying with these global developments. This comes at a time of significant wider disruption and uncertainty due to external factors, including Brexit and the Covid-19 pandemic.

For years, Brexit has created significant uncertainty for businesses across all sectors as they are forced to adapt to a new economic environment and plan for the impact on future trading relationships. While some of the recent developments in terms of the Withdrawal Agreement have provided clarity around the position on trade in goods, there is still significant uncertainty around the position for service providers.

To compound this, the unprecedented global impact of the Covid-19 outbreak has obviously had a sweeping and unparalleled impact on businesses and individuals alike, as governments' strict lockdown measures have forced a distinct change in consumer habits.

The response to the pandemic has triggered a dramatic increase in consumers use of digital services, with many people trying online services for the first time due to the crisis. New EY research on 7 Impacts of COVID-19 on the UK digital household, conducted on 2,000 UK households and exploring the impact of Covid-19 on TMT products and services, has found that video calling has shown the largest increase, with 18% of people trying this for the first time, followed by online shopping (9%) and consumption of catch-up TV (9%).

It seems that certain sub-sectors within the TMT sector overall are not negatively affected, putting them in contrast to many other industries that are unable to continue trading under the restrictions. Digital streaming services and gaming companies are experiencing particularly increased demand, with 37% of households saying their TV and content consumption habits will permanently change.

This article will address the ongoing developments to global tax measures that are impacting the TMT sector and the challenges that businesses are facing in a time of wider economic and political uncertainty. Specifically, we will focus on the introduction of new taxes in the form of DSTs, the continuing trend towards taxing the supply of digital services based on the destination principle and a look at the future for e-commerce operators in the EU as a result of the 2021 changes.

Digital services taxes

For years, tax policymakers around the world have been trying to tackle the issue of whether and how to modernise an international tax framework that is over a century old and has been argued to no longer be fit for taxing some elements of globalised businesses. For digital businesses, the historic method of attributing taxing rights appears at odds with the place where value is created, as new business models have emerged which enable companies to derive income from user interaction in territories where the business has no physical presence. In short, the current rules are therefore no longer considered to work appropriately for all business models in an increasingly globalised world.

The OECDs Inclusive Framework (IF) group, set up as part of the OECD Base Erosion and Profit Shifting (BEPS) project, includes representation from over 130 countries and is leading the OECDs work on addressing the tax challenges of the digital economy to try and reach consensus on changes needed to the international tax system. The OECDs workplan consists of two Pillars: Pillar 1 proposes a Unified Approach to profit allocation and nexus rules; and Pillar 2 proposes a global minimum tax to address tax avoidance.

Despite ongoing development of proposals, it would appear that progress towards a multilateral solution is not coming fast enough for some countries. Faced with a fast-tracked but nevertheless timely process at the OECD level and with the EU bloc-wide interim DST measure waiting on such progress, we are now seeing an acceleration in the adoption of unilateral digital services tax measures.

Among the OECD countries, Austria, France, Italy, Turkey and the UK have already implemented DSTs, with a number of others looking to follow suit. One of the key challenges facing businesses is tracking the introduction of these new taxes and assessing whether they may be caught. As individual countries are pursuing unilateral measures, there are significant differences in the scope of the taxes being introduced. These problems are often exacerbated by limited or unclear tax authority guidance on the matter.

While some EU territories, such as France and Italy, have opted to follow the EUs compromise text by capturing digital intermediation and online advertising activities, the legislation in Turkey for its DST and in India with its Equalisation Levy has been drafted much more widely. The UK legislation, on the other hand, focuses specifically on whether the business provides one of three in scope activities: social media services; a search engine; or an online marketplace. A business that concludes it is not within the scope of the UK DST may not necessarily reach the same conclusion in Turkey. With limited consistency and no one size fits all approach available, businesses must continuously monitor developments to determine whether they are caught by the new rules.

On top of this, there is a huge distortion between the applicable DST rates, ranging from 2% in the UK to 7.5% in Turkey, with scope for this to be extended up to 15%.

Businesses also face practical challenges from a systems and process perspective, in determining what solutions and data they have in place to identify user location and

how to allocate revenue using a method that is in line with individual country requirements. Impacted businesses are therefore having to initiate complex and time intensive projects to calculate DST liabilities on a country by country basis. HMRCs published guidance on the UK DST states that any attribution method must be just and reasonable, which is sympathetic to the fact that each individual business will need to approach the calculation in different ways. However, this does not necessarily mean that an attribution method that is suitable for the UK DST will translate easily for use in another country.

So, whats next? Countries which have unilaterally implemented a DST have said that they will repeal the tax once international agreement is reached at the OECD level, which had an ambitious timetable to achieve a consensus-based solution by the end of 2020. However, due to the Covid-19 outbreak, progress has inevitably slowed. In the recent OECD Tax Talks webcast, Pascal Saint-Amans confirmed that the OECD still intends to deliver a consensus-based solution to digital taxation to the G20 in November; however, some elements may shift into 2021.

Therefore, the natural conclusion is that the existing DSTs in place may be around for longer than perhaps first intended, with many other countries seeking to introduce rules in the short to medium term.

VAT on digital services

The 2015 VAT place of supply changes were amongst the most significant indirect tax compliance changes that businesses in the TMT sector had ever faced, with a shift towards taxing the supply of business to consumer (B2C) telecoms, broadcasting and electronic (TBE) services based on the destination principle; i.e. where the recipient of the service is located. Five years on, the number of countries that are seeking to mirror this approach shows no sign of slowing down, with the compliance footprint of businesses that supply cross-border digital services growing year on year.

Across the EU, the VAT rules on TBE services are clearly defined, with a definition of electronically supplied services fixed in statute alongside set instructions on determining customer location and status, and clear rules that shift the responsibility for VAT accounting on to larger online marketplace platform operators.

While some territories such as the United Arab Emirates have recognised the relative success of the EU changes and closely aligned their respective regimes to the EU model, other recent and proposed implementations elsewhere have diverged in various aspects, where it is not uncommon for onerous local conditions to be coupled with unclear guidance. This can mean that in a practical sense, it is difficult and cumbersome for businesses to comply with new global indirect tax rules on e-services.

Typical issues that businesses face in navigating these include:

- the requirement to comply with local language requirements; i.e. for invoicing, return filing and liaison with the tax authority (e.g. Saudi Arabia);
- low/nil registration thresholds requiring local registration for low number of supplies (e.g. Russia);
- the requirement to appoint local fiscal representatives, where joint and several liability provisions make it difficult to identify businesses willing to take on this responsibility (e.g. Egypt);
- lack of clarity on marketplace provisions leading to commercial issues between app developers and marketplaces (e.g. Quebec); and
- an inability to register without a local permanent establishment (e.g. Tanzania).

In addition to some of these practical issues, an emerging trend in recent years has seen business to business supplies (B2B) also increasing included within the scope of local VAT when supplied cross-border. South Africa introduced rules in 2014 and, more recently, countries including Russia and Malaysia have followed suit, widening the net of businesses that are impacted by such measures and even requiring businesses to register in respect of intercompany supplies.

Another emerging trend is the growing number of countries, most notably in Latin America (LATAM), that are implementing measures to tax B2C supplies of digital services, albeit via a withholding mechanism. Under these rules, payment intermediaries (e.g. credit card companies and banks) are held responsible for withholding and remitting the VAT to the tax authorities. While the digital service provider may not have a registration requirement in this instance, it is still likely to impact pricing and margin decisions. Equally, uncertainty exists as to who the liability rests with where the payment processor fails to remit the VAT, adding to the complexity that businesses must now deal with when supplying customers in these countries.

Perhaps the biggest issue that TMT businesses face is how to monitor all of these developments and the nuances between each. While some countries announced rules with a significant lead in period (such as Australia and New Zealand), many other countries simply introduce rules with minimal warning; some with less than a month's notice.

With the number of countries introducing such rules increasing each year, and with the types of regimes being introduced changing in terms of the services covered and the local requirements, the need to continuously monitor these changes and react accordingly has never been greater. Businesses should now turn their attention to monitoring those key regions that are behind the curve in terms of implementing such regimes, principally LATAM and Africa where this is gathering momentum.

> Although we expect the changes to minimise compliance burdens, businesses should not underestimate the cost of systems changes.

2021 VAT e-commerce package

From 1 July 2021, a further suite of EU legislative changes will impact the way in which e-commerce operators are taxed in the EU and expand the current scope of the Mini One Stop Shop (MOSS). This was intended to take effect from 1 January 2021; however, this has been postponed in light of the Covid-19 outbreak, in order to give businesses more time to prepare. The changes come as part of the EUs VAT e-commerce package, designed to reflect the changing commercial landscape and create a level-playing field between EU and non-EU businesses, whilst minimising compliance burdens for suppliers.

The MOSS is a simplified system, introduced as part of the aforementioned 2015 changes, which allows businesses to declare and pay local VAT due across the EU on B2C supplies of TBE services via a single return in one EU country. From 2021, this will become a One Stop Shop (OSS), extended to include (depending on the scenario) B2C supplies of services other than TBE services, intra-EU distance sales of goods, certain domestic supplies of goods facilitated by electronic means and importations of consignments not exceeding €150.

In line with the commitment to apply the destination principle to VAT, the current distance sales thresholds will be abolished and will be replaced by the EU wide €10,000 threshold currently applicable to digital sales. This means that businesses

supplies will increasingly fall within the scope of VAT in overseas territories, requiring knowledge of individual VAT rates and requirements across all markets into which they sell - a level of detail that many businesses previously would not have required.

Another key change is that online marketplaces may in certain circumstances be deemed for VAT purposes to be the supplier where they facilitate the cross-border B2C supply of goods and will be responsible for collecting and paying the VAT. This has the potential to create significant additional VAT reporting obligations for platforms.

Although we expect the changes to minimise compliance burdens and result in significant compliance cost savings due to a smaller registration footprint, businesses should not underestimate the cost of implementing systems changes that will be required to reflect the new rules, and therefore the benefit of these improvements may not be felt immediately.

All of these changes form part of the EUs overarching long-term goal of creating a single European VAT area. However, with the end of the Brexit transition period looming on 31 December 2020, UK businesses EU VAT footprint may look very different going forward. They will no longer be able to use the Union MOSS scheme via the UK and so will need to consider whether to transition to the non-Union scheme and register for MOSS in another EU member state (with Ireland being the popular choice amongst UK MOSS businesses for language reasons). With the 2021 changes on the horizon, the list of developments that businesses within the sector must address grows ever longer.

Conclusion

Summarising and reflecting on all of the key tax developments that businesses within the sector face poses the question: has there ever been a more challenging time for an indirect tax function? The combination of sector-specific developments with the introduction of DSTs and increasing number of countries applying VAT on supplies of digital services, in conjunction with the uncertainty posed by Covid-19 and Brexit, means that tax functions will need to be better equipped than ever to respond to change and help steer their organisations through this at pace. Some argue that the international tax system has failed to evolve at sufficient pace in response to the digital economy; businesses operating within the sector today will

not be afforded the same luxury.

- We should very much appreciate your completing our survey about the impact of coronavirus on you and your organisation. We are gathering this information to help us continue to support and inform you. Please click here to complete the survey. The closing date is 30 June and we shall provide a report on our websites in July.