

International Tax

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The focus of this article is on the response of various governments to the loss of income tax and sales tax revenue caused by the shift of sales from traditional brick and mortar stores to e-commerce sellers through disruptors of the traditional economy such as Netflix and Uber.

I. Argentina

Although Argentina has a long way to go to thoroughly address Base Erosion and Profit Sharing (BEPS) Action 1,¹ some measures already have been taken at both the National and Provincial levels. At a national level, the comprehensive tax reform published in December 2017² amended the

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1. OECD, ADDRESSING THE TAX CHALLENGES OF THE DIGITAL ECONOMY (2015), <https://doi.org/10.1787/9789264241046-en>.

2. Law No. 24730, Dec. 29, 2017 (Arg.).

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Value-Added Tax Law³ (VAT) by including as a taxable event the provision of digital services through any application. Digital services include not only the hosting of websites but also other services aimed at offering or facilitating the presence of individuals or entities online. This law became effective January 1, 2018.⁴

The tax reform includes the presumption that the effective exploitation of the digital services is deemed to be located in Argentina when services are rendered by a non-resident provider and the following items are located in Argentina: (1) the IP address of the device used by the customer or SIM card country code, (2) the billing address of the client, (3) the bank account used for paying such services, and/or (4) the billing address of the customer of such bank or financial institution issuing the credit or debit card used for purposes of such payment.⁵ Regulations for purposes of the VAT on digital services⁶ set forth that the responsible party of such VAT is the customer—or the intermediary entity that facilitates and manages the relevant payments by itself or as a collection and payment agent.

At the provincial level, only Córdoba and Salta have amended their local tax codes to capture indirect tax on revenue generated from digital services. Both provinces set forth that a taxable event for turnover tax⁷ purposes exists where there is a provision of a service that requires online subscription to access online entertainment that is broadcast through the internet. The turnover tax also will apply to the intermediation of services such as Uber or Airbnb and online game activity, regardless of the location of the servers or digital platform.⁸ Other provinces such as the City of Buenos Aires are considering amendments of their local tax codes so as to extend the scope of their turnover tax to revenue generated from the provision of digital services. The amendments likely will include an amendment to the concept of “significant digital presence.”

For Income Tax purposes, Argentina has not yet determined how or whether to levy an income tax on digitally generated revenue.

3. Law No. 23349, Aug. 7, 1986., B.O. 25978 (Arg.) (amending Law No. 20631 which was organized by Decree 280/97, as amended).

4. EY, *Key aspects of the Argentine tax reform discussed*, TAX NEWS UPDATE (Jan. 9, 2018), <https://taxnews.ey.com/news/2018-0047-key-aspects-of-the-argentine-tax-reform-discussed>.

5. *Id.*

6. Decree 354/2018, Apr. 23, 2018 (Arg.); General Resolution 4020/2018, Mar. 31, 2017 (Arg.).

7. Turnover tax is an indirect tax levied by the 23 provinces and the City of Buenos Aires. (EY, *Argentine Province of Cordoba imposes turnover tax withholding system on nonresidents*, AMERICAN TAX CENTER (July 19, 2017), <https://www.ey.com/gl/en/services/tax/international-tax/alert-argentine-province-of-cordoba-imposes-turnover-tax-withholding-system-on-non-residents>).

8. ToDoTvNews, *Netflix and Spotify to Face Taxes in Argentina*, TTVNEWS (May 7, 2017), <http://www.todotvnews.com/news/Netflix-and-Spotify-to-Face-Taxes-in-Arentina.html>.

II. Australia

“Residency” of a taxpayer and “source” of income are fundamental to establish whether an entity will be subject to tax in Australia.⁹ As such, income generating activities must have a sufficient nexus to Australia before Australia can assert its taxing rights. Subject to its international double taxation agreements, Australia generally seeks to impose income tax on the worldwide income of resident businesses (with credits for overseas tax paid and, in certain circumstances, exemptions—e.g., for non-portfolio dividends, branch profits, and certain offshore capital gains).¹⁰ Non-residents carrying on business through “permanent establishments” (PE) are taxed on their business income generated in Australia as well as income and capital gains on land and “land rich” entities.¹¹ Interest, dividends, and royalties earned in Australia and paid off-shore are subject to withholding taxes (subject to treaty relief).¹² This tax regime is supplemented by an accruals taxation regime (CFC rules), which taxes Australian residents on certain amounts earned in foreign branches and foreign subsidiaries.¹³

Recently, through the Multinational Anti-Avoidance Law (MAAL), Australia’s taxing jurisdiction has been extended by targeting certain structures designed to avoid permanent establishment for significant global entities.¹⁴ The main targets of this effort have been players in the digital economy.

The Australian goods and services tax (GST) also may apply to supplies with a relevant connection with the “indirect tax zone”¹⁵—a test that, in the context of digital supplies, usually would require such supplies to be made through a presence in Australia. But, perhaps as a forerunner to further changes being considered, Australia extended the application of GST to digital products and other intangible supplies made by offshore suppliers to “Australian consumers” from 1 July 2017¹⁶—a measure that has drawn in businesses with no presence in Australia into the GST regime.

Historically, multi-nationals had supply chains located across numerous jurisdictions with assets, labour, and staff in different countries. PE rules would allocate profits to the location of the multi-national’s labour, assets

9. Board of Taxation, *Reforming the Income Tax Residency Rules for Individuals*, AUSTRALIAN GOVERNMENT (Sept. 2018), <https://cdn.tspace.gov.au/uploads/sites/70/2018/07/T307956-income-tax-res-rules.pdf>.

10. *Income Tax Assessment Act 1997* (Cth) sub-divs 768-A & 768-G (Austl.); *Income Tax Assessment Act 1936* (Cth) s 23AH (Austl.).

11. *Income Tax Assessment Act 1997* (Cth), s 6-5, div 855 (Austl.); *Income Tax Assessment Act 1936* (Cth), s 6(1) (Austl.).

12. PWC, *Australia Corporate – Withholding taxes*, WORLDWIDE TAX SUMMARIES (Dec. 1, 2018), <http://taxsummaries.pwc.com/ID/Australia-Corporate-Withholding-taxes>.

13. *Income Tax Assessment Act 1936* (Cth), Part X (Austl.).

14. *Income Tax Assessment Act 1936* (Cth), s 177DA (Austl.).

15. *A New Tax System (Goods and Services Tax) Act 1999* (Cth), s 9-25 (Austl.).

16. *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Act 2016* (Cth), s 3 & sch 1 (Austl.).

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capital, and legal or commercial risks that generate that income. The prevalence of digitalised businesses operating online has been identified as a threat to Australia's tax base. The 'traditional' residency and source models (and other features of Australia's tax system such as thin capitalisation, transfer pricing, and CFC rules designed to protect Australia tax base), are unable to address the challenges associated with digitalised business that can generate significant revenues from Australia with little or no physical presence in Australia.

Australia's Treasury addresses this issue in its discussion paper titled "The digital economy and Australia's corporate tax system."¹⁷ It recognises that current rules determining Australia's taxing rights over digitalised businesses focus on physical presence as an indicator of economic presence. It suggests this concept needs to adapt to the changing economy in which mobile intangible assets located anywhere sees digitalised businesses disrupting traditional business models and eroding Australia's tax base.

The reliance by many foreign resident digitalised businesses on user-generated content (social media), user data (search engines), or user participation (booking websites/applications) raises concerns that value created by Australian users escape the scope of Australia's income tax laws (despite Australia implementing many actions proposed by the BEPS Project). International discussion regarding user-created value is based on "the idea that a country that provides the market where a foreign enterprise's goods and services are supplied on its own provides a sufficient link to create a nexus for tax purposes."¹⁸

The Australia Treasury's Paper seeks to comment on potential changes to domestic laws and international agreements to target the perceived tax leakage posed by digitalised businesses. It explores whether changes could be made to existing profit attribution rules so that taxing rights could reflect user-created value or the value associated with intangibles. For instance, if user data or user contributions were to create taxing rights, law maker would have to agree on a mechanism to estimate the value of such user data or user-generated content. The Treasury's Paper raises questions about the need for a replacement of the arm's length principle with formulary apportionment, a "location of user" basis for source, and a "virtual PE" (which would attribute profits to entities calculated as a percentage of profits based on industry and type of services provided). The Paper further observes that in the absence of short-term consensus at the Organization for Economic Co-Operation and Development (OECD) level, there may be a need for interim measures (recognising the activity of other jurisdictions in

17. THE TREASURY OF THE AUSTRALIAN GOVERNMENT, THE DIGITAL ECONOMY AND AUSTRALIA'S CORPORATE TAX SYSTEM (2018), <<https://static.treasury.gov.au/uploads/sites/1/2018/10/c2018-t306182-discussion-paper-1.pdf>>.

18. OCEF, TAX CHALLENGES ARISING FROM DISITALISATION – INTERIM REPORT 2018 172 (2018), <https://www.oecd-ilibrary.org/docserver/9789264293083en.pdf?expires=1553192988&id=id&accname=guest&checksum=B59A4512CBDA09BF9CBB8176D1CC2F5E>.

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this regard – e.g., Hungary, Italy, Spain, and India).¹⁹ Such interim measures will need to apply an appropriate “nexus test” and appropriate thresholds for its application.²⁰ It is expected that in the coming months Australia is likely to introduce interim measures addressing those revenue concerns.

III. Brazil

The Brazilian Constitution provides for three levels of government (Federal, State, and Municipal), each with its own competence to impose taxes.²¹

Brazil does not impose direct tax liability on foreign entities (which usually are taxed through withholding taxes) and does not have clear permanent establishment rules. But Brazil does have specific rules on taxation of representatives or commissionaires of foreign persons.²²

In addition to income taxation, Brazilian companies are subject to a large number of transactional taxes. The most important of these taxes are the Brazilian excise tax (ICMS) (tax on transactions of circulation of goods and services of transportation and communication), which are charged by the States, the Brazilian Municipal Service Tax (ISS) (tax on services in general), and municipalities. These taxes date back to the 1960s and are not originally designed to capture the realities of the digital economy. This results in a significant effort of interpretation and frequent conflicts in their application.

At a more general level, the first issue of qualification is whether the digital product constitutes a good, a service, or a royalty not identifiable as a good or service. If it is a good (equivalent to merchandise), it will potentially be subject to ICMS and not to withholding taxes. The Brazilian Supreme Court has determined that standard (off the shelf) software, sold in large scale transactions, constitutes a good and is, therefore, subject to ICMS.²³

If the product is a service, it will potentially be subject to ISS and to withholding taxes. Levy of the ISS depends on the service being listed in a federal law, which has been expanded to encompass new services of the digital economy.²⁴ Services of a technical nature are subject to a withholding income tax of 15 percent and a contribution named Contribution for Intervention in the Economic Domain (CIDE) of 10 percent (not an income tax, and consequently with no foreign tax credit and not subject to double tax

19. THE TREASURY OF THE AUSTRALIAN GOVERNMENT, *supra* note 17 at 23.

20. *Id.*

21. CONSTITUIÇÃO FEDERAL, título VI (Braz.), http://www.planalto.gov.br/ccivil_03/Constituicao/Constituicao.htm.

22. Lei No. 3470/58, de 28 de Novembro de 1958, art. 76 (Braz.), http://www.planalto.gov.br/ccivil_03/LEIS/L3470.htm.

23. S.T.F., RE 176626 SP, Recurso Extraordinário 176.626-3, de 10 de Novembro de 1998 (Braz.), <https://stf.jusbrasil.com.br/jurisprudencia/740089/recurso-extraordinario-re-176626-sp>.

24. Lei Complementar 116/03, de 31 de Julho de 2003 (Braz.) http://www.planalto.gov.br/ccivil_03/LEIS/LCP/Lcp116.htm.

treaties) when paid to foreign providers (in addition to turnover taxes of 9.25 percent). Services of a non-technical nature are subject to a withholding income tax of 25 percent and not CIDE (in addition to turnover taxes of 9.25 percent).

If the digital product does not qualify either as a good or as a service, it may not be subject to ICMS or ISS. That position is becoming less common because both States and Municipalities are constantly trying to expand their reach²⁵, and the Brazilian Supreme Court has been moving away from the traditional concepts of goods as tangible property only and of services as the product of human activity only.²⁶

A royalty that does not qualify as a good or a service requires further classification to determine its specific tax regime. If the agreement involves the transfer of technology, the withholding income tax of 15 percent and CIDE of 10 percent apply, but the turnover taxes of 9.25 percent does not apply. Deductibility of the expense is subject to a special set of rules that allows a maximum royalty of 5 percent of net revenues. No transfer pricing rules apply. A software license without the transfer of the source code is subject to the withholding income tax of 15 percent, but it is not subject to CIDE or turnover taxes. Additionally, software licenses are subject to the ISS. Other intangibles, such as distribution rights, software, and other digital products may be subject to other specific rules. For example, standard software acquired for the use of the acquirer was considered by the Brazilian Revenue as merchandise that is not subject to withholding tax. But the same software acquired for copy and distribution was considered an intangible, subject to the withholding tax.²⁷

IV. Canada

While Canadian consumers of foreign-based digital services are currently responsible for self-assessing applicable sales taxes, the government has acknowledged this rarely happens, resulting in lost revenue at both the federal and provincial levels. As a limited response, the federal government entered into a deal with Netflix, which states the company committed to invest \$500 million into Canadian productions over a five-year period instead of requiring Netflix to collect and remit sales tax.²⁸ Furthermore, as

25. See Decisão Normativa CAT 4/17, 9.4.2009, DIÁRIO OFICIAL DOS ESTADOS [D.O.E.], 10.4.2009 (Braz.) (stating that physical existence is not a requirement to characterize merchandise), http://info.fazenda.sp.gov.br/NXT/gateway.dll/legislacao_tributaria/decisoes_normativas/denorm062009.htm?f=templates&fn=default.htm&vid=sefaz_tributaria:vtribut.s&fn=default.htm&vid=sefaz_tributaria:vtribut.

26. See, e.g., S.T.F., RCL 31580 / SP, Relator: Min. Edson Fachin, 6.10.2018, <http://portal.stf.jus.br/processos/downloadPeca.asp?id=315218770&ext=.pdf>.

27. C.P.F., Cosit Fls. 2, 18 de novembro de 2016, <http://normas.receita.fazenda.gov.br/sijut2consulta/link.action?idAto=79056&visao=anotado>.

28. *Netflix Set to Invest \$500 Million in Canadian Programs*, TORONTO SUN (Sep. 27, 2017), <https://torontosun.com/2017/09/27/netflix-set-to-invest-in-500-million-in-canadian-programs/wcm/d35334b0-1aa1-4d11-9876-9caed76b4ab0>.

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a member of the OECD, Canada is involved in a multilateral process to develop an international standard for collecting tax on digital services by 2020, which will follow a report set to be released in 2019.

Although some countries (such as Australia) and the European Union have announced an intention to implement interim measures, Canada does not intend to take action at the federal level until an international consensus is reached. Canada's approach appears consistent with comments by the US Treasury Secretary, urging other members of the OECD to complete the process currently underway instead of taking unilateral action.²⁹ However, the government in the province of Québec decided to collect sales tax on digital services as of January 1, 2019, and finalized legislative amendments that will shift the obligation to collect and remit sales tax on certain digital services away from the consumer to the supplier.³⁰ Given that the federal government has not implemented a similar policy, parties subject to the new rules in Québec are obliged to collect only the provincial portion of sales tax.³¹

The amendments essentially require certain non-resident suppliers and digital platforms to register under the Act respecting the Québec Sales Tax to collect and remit the Québec sales tax applicable to certain taxable supplies made to Québec consumers. For foreign-specified suppliers, the amendments came into force on January 1, 2019, while Canadian specified suppliers and operators of specified digital platforms have until September 1, 2019, to comply with Québec's registration requirements (set out in new Chapter VIII.1 of the Act respecting the Québec Sales Tax).³²

Under the new Chapter VIII.1, if a specified supplier (essentially a supplier that is conducting business outside Québec) or an operator of a specified digital platform is not otherwise registered for Québec sales tax purposes, the supplier or operator must now register as of the first day of the month in which the supplier's or operator's specified threshold exceeds

29. Secretary Statement & Remarks, U.S. Department of the Treasury, Secretary Mnuchin Statement on Digital Economy Taxation Efforts, *Press Release* (Oct. 25, 2018), <https://home.treasury.gov/news/press-releases/sm534>.

30. Amendments to the Act respecting the Québec Sales Tax, R.S.Q., c T-0.1 (Can.); The Tax Administration Act, R.S.Q., c A-6.002 (both were assented to on June 12, 2018 (formerly referred as Bill 150)).

31. Article 16 of the Act respecting the Québec Sales Tax sets the rate of Québec sales tax at 9.975%. The new collection provisions found in article 447.6 of the Act respecting the Québec Sales Tax specifically requires that applicable taxpayers collect the tax payable by a recipient under section 16, which does not include the federal goods and services tax (GST).

32. A "foreign specified supplier" is a specified supplier that does not carry on business in Canada or have a permanent establishment in Canada, and is not registered under section 240 of the Excise Tax Act, R.S.C., 1985, c E-15 (Can.). Conversely, a "Canadian specified supplier" is a specified supplier that is registered under section 240 of the Excise Tax Act. A "specified digital platform" is a digital platform for the distribution of property or services, through which a particular person enables a separate specified supplier to make a taxable supply in Québec, where the particular person controls the essential elements of the transaction between the specified supplier and the recipient (defined in the Act respecting the Québec Sales Tax, R.S.Q., art. 477.2 (Can.)).

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C\$30,000.³³ A newly registered specified supplier who makes a taxable supply in Québec of incorporeal movable property or a service to a specified Québec consumer must collect the Québec sales tax payable by the recipient.³⁴ The onus is on the supplier to determine whether a given recipient is a specified Québec consumer by obtaining identification in the ordinary course of business that is indicative of residence.³⁵

For Canadian specified suppliers, the obligation to collect Québec sales tax also extends to taxable supplies of corporeal property.³⁶ Furthermore, supplies of incorporeal movable property made by a foreign specified supplier to a specified Québec consumer are deemed to be made in Québec, notwithstanding presumptions to the contrary set out elsewhere in the Act respecting the Québec Sales Tax.³⁷ Finally, if an operator of a specified digital platform, acting as an intermediary, receives an amount for such taxable supplies, the operator has the obligation to collect the applicable Québec sales tax.³⁸

Newly registered suppliers are subject to quarterly filing and remittance obligations. In computing the net tax, a deduction is available for any refunds made in respect of Québec sales tax charged in error. For a person registered under the general registration system who is not a specified Québec consumer, any Québec sales tax that was mistakenly collected by the non-resident supplier can be refunded only by that non-resident supplier. However, a specified Québec consumer is permitted to apply for a rebate from either the non-resident supplier or from Revenu Québec.³⁹ Finally, there is a penalty in place to ensure compliance by the recipient. A recipient who evades (or attempts to evade) paying Québec sales tax by providing false information regarding his or her residency will be liable for the greater of \$100 or 50 percent of the amount that was evaded (or that the recipient intended to evade).⁴⁰

33. The following definitions are found in art. 477.2: a “specified supplier” is a supplier that does not carry on business in Québec, does not have a permanent establishment in Québec, and is not registered under Division I of Chapter VIII.” The “specified threshold” for a particular month is the total of all amounts that became due or were paid in the preceding 12 months, as consideration for making taxable supplies of incorporeal movable property to a consumer in Québec (The Act respecting the Québec Sales Tax, R.S.Q., art. 477.5 (Can.)).

34. A “specified Québec consumer” is the recipient of a supply, who is not registered under Chapter VIII, Division I and whose usual place of residence is Québec. However, if the recipient of a supply of incorporeal movable property or services provides the supplier with a Québec sales tax registration number then the supplier can consider the recipient not to be a specified Québec consumer (*Id.* art. 477.2).

35. *Id.* art. 477.3.

36. *Id.* art. 477.6.

37. *Id.* art. 477.4.

38. DELOITTE, THE NEW QST REGISTRATION REGIME FOR NON-RESIDENTS SELLING INTO QUEBEC – IMPORTANT CLARIFICATIONS 2 (2018).

39. *Exports of Property – Zero-rated Property*, REVENU QUEBEC (2018), <https://www.revenuquebec.ca/en/businesses/consumption-taxes/gsthst-and-qst/special-cases-gsthst-and-qst/exports/exports-of-property/>.

40. The Act respecting the Québec Sales Tax, R.S.Q., art 477.19 (Can.).

It remains to be seen how effective the new measures implemented by Québec will be in recuperating the revenue currently lost by the government. While other Canadian provinces have not followed suit, success by Québec may incentivize others to develop a similar regime.

V. China

China surpassed the US in 2014 to become the largest e-commerce market globally. The 2018 b2c (business to consumers) retail e-commerce is estimated to be US\$590 billion dollars, with the prediction that by 2021, the figure will exceed US\$950 billion dollars.⁴¹

In July 2016, at a meeting of G20 finance ministers in Chengdu in Sichuan province, Mr. Lou Jiwei, China's Minister of Finance said, "Innovation doesn't necessarily mean tax cuts. The first thing we need to do is to ensure fair taxation."⁴² Additionally, Mr. Jiwei said, "We should levy taxes on the digital economy, but it is very difficult to do so. The digital economy has an increasingly stronger social influence, and there are also vested interest groups."⁴³

China has, by the latest count, more than fourteen types of taxes, including income taxes, turnover taxes (such as VAT – Value Added Tax, Consumption Tax), and ad valorem taxes (such as property tax). In terms of ranking by the size of tax revenue, VAT has always been the largest revenue source, collecting more than double the amount of revenue from China's corporate income tax.⁴⁴

A. CROSS BORDER ONLINE SALES INTO CHINA

In March 2016, the General Administration of Customs (GAC) and the State Administration of Taxation (SAT) issued the Circular on Tax Policies for Retail Import in Cross-Border E-Commerce,⁴⁵ which changed China's tax policy for retail imports in cross-border e-commerce. Previously, cross-border e-commerce transactions were treated as personal parcels and subject to VAT and customs duty tax when they crossed a *de minimis* threshold.⁴⁶

This circular was a significant change. It was aimed at closing tax loopholes and facilitating fairness of trading. The new tax policy, effective

41. *Total retail e-commerce revenue in China 2017-2023*, STATISTA (June 2018), <https://www.statista.com/statistics/246041/forecast-of-b2c-e-commerce-sales-in-china/>.

42. *China's digital economy hard to tax, says finance chief*, SOUTH CHINA MORNING POST, July 24, 2016.

43. *Id.*

44. STATE TAXATION ADMINISTRATION OF THE PEOPLE'S REPUBLIC OF CHINA, REVENUE STATISTICS 1 (2015).

45. See, e.g., KPMG, *China's New Import Tax Policies for Cross-border E-commerce worth the attention of the whole industry*, CHINA TAX ALERT 14 (March 2016), <https://home.kpmg/cn/en/home/insights/2016/03/china-tax-alert-14-cross-border-ecommerce.html>.

46. *Id.*

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April 8, 2016, made changes to types of taxes, tax rates, and purchase price cap of imported commodities.⁴⁷

The new tax policy mandated that all cross-border e-commerce transactions be subject to import taxes with no exemptions allowed.⁴⁸ Single transactions below RMB 2,000 (about US\$290) and total annual transactions for one person below RMB 20,000 (approximately US\$2,900) qualified for a temporary zero percent tariff rate and reduced import VAT (Value Added Tax) and CT (Consumption Tax) rates.⁴⁹

“In addition, the customs authorities published a whitelist involving 1,142 commodity items, stipulating that only those on the list can be imported to China through cross-border e-commerce.”⁵⁰ This whitelist was issued by eleven government agencies, including the Ministry of Finance and the National Development and Reform Commission.⁵¹ Only goods bearing HS codes shown on the list are importable under the March 2016 announced tax policy for cross-border e-commerce. All other goods are importable under the general trade system.⁵²

The concurrent release of the new tax policy (announced in March 2016 with published effective date of April 8, 2016) on ecommerce and the “whitelist” caused tremendous logistical problems for many ecommerce firms, such as obstacles in the customs clearance of some commodities.⁵³ “For example, after the release of the first list, there were reports that some cross-border e-commerce enterprises were unable to get clear baby formula, which was not on the list, leaving the products ‘stuck’ in bonded warehouses.”⁵⁴ Many firms were forced to shut down, as they were hit by cash strains or insufficient supply of certain goods.

In response to the severe negative effect to e-commerce firms and the consumers in China, the Chinese government postponed the effective date of the new tax policy announced in Cai Guan Shui [2016] 18, not once, but

47. *Id.*

48. *Id.*

49. *Id.*

50. *New tax regime has shaken up China's cross-border e-commerce sector*, TECHNODÉ (April 14, 2017), <https://technode.com/2017/04/14/new-tax-regime-has-shaken-up-chinas-cross-border-e-commerce-sector/>; *see also* Juha Hiltunen, *Using E-Commerce and Growth Hacking to Enter the Chinese Market* (Nov. 6, 2017) (unpublished B.A. thesis, Helsinki Metropolia University of Applied Sciences), available at <https://pdfs.semanticscholar.org/c47b/f38e23f7a39f419e91ebb917228cd300649.pdf>.

51. *Cross-Border E-Commerce: China Policy Update*, HKTDC RESEARCH (June 8, 2016), <https://hkmb.hktdc.com/en/1X0A6AHP/hktdc-research/Cross-Border-E-Commerce-China-Policy-Update>.

52. *See id.*

53. *See E-commerce in China*, EXPORT VIRGINIA (August 2018), http://exportvirginia.org/wp-content/uploads/2018/08/E-Commerce_China_Aug_2018.pdf.

54. *See id.* at 12.

twice.⁵⁵ The first postponement deferred the effective date from April 8, 2016, to the end of 2017.⁵⁶ The second postponement further delayed the effective date to the end of 2018.

VI. European Union

A recent E.U. study concluded that while brick and mortar companies in the European Union pay corporate income tax at a rate of approximately 23 percent, digital companies pay at a rate of approximately only 9 percent.⁵⁷ Not surprisingly, this difference has caught the attention of various taxing authorities—including those within the European Union.

Although the idea stems initially from the European Union, the taxation of digital companies within Europe has, in particular, caught the attention of French politicians and its taxing authorities.⁵⁸ Though it is still entirely unclear as to what type of activities may eventually be subject to the digital tax, initial discussions have focused on revenues generated from digital media advertisements, digital interfaces used for people to communicate with one another, sales of certain goods, and services as well as from revenues generated by companies exploiting user data.⁵⁹ Only “larger” companies are to be subject to digital taxation, meaning only those that have annual worldwide revenues in excess of EUR 750 million, of which EUR 50 million have been generated in the European Union.⁶⁰

A tax rate of three percent of revenues is being discussed.⁶¹ The tax is to be levied only in the E.U. member state where the users are located; for this, the respective IP address or other geolocation options will be determinative (this may eventually be an issue from a data privacy perspective). Double taxation is to be avoided by allowing the taxpayer to deduct the digital tax from its taxable income. The idea is also to introduce a one-stop-shop approach in that a separate digital tax return would be used to impose the digital tax. As the digital tax rate is to be uniform throughout the European Union, forum shopping within the European Union should not be an issue.

55. See *China's import tax policies for cross-border e-commerce*, KPMG (April 2016), https://assets.kpmg/content/dam/kpmg/pdf/2016/04/china-tax-weekly-update-12.pdf?_ga=2.164235007.1345695567.1554084210-1839469265.1553973198.

56. *Id.*

57. See Shakuntala Banerjee, *Digitalsteuer: Wird das die Zukunft der Besteuerung?*, March 23, 2018, <https://www.zdf.de/nachrichten/heute/moscovici-will-digitalsteuer-fuer-konzerne-100.html>.

58. Bjarke Smith-Meyer & Nicholas Vinocur, *France's lonely crusade for a 'digital tax'*, POLITICO.EU, March 22, 2018, <https://www.politico.eu/article/france-digital-tax-lonely-crusade-germany-cool-on-idea/>.

59. *Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence*, EUROPEAN COMMISSION, March 21, 2018, https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_significant_digital_presence_21032018_en.pdf.

60. See *The European Union's Proposed Digital Services Tax: A De Facto Tariff*, PIIIE (June 2018), <https://piie.com/system/files/documents/pb18-15.pdf>.

61. *Id.*

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E.U. member states are not in agreement on the implementation of a digital taxation. For example, the German *Bundesrat* (Germany's upper house of parliament that represents Germany's 16 states) believes that companies that provide digital services only as a "secondary" business should be exempt from this tax.⁶² Denmark, Sweden, and Ireland are reluctant to introduce such a tax altogether. This is partially because not only may such a tax be viewed as a retaliatory European answer to the high profits of US conglomerates such as Google, Apple, Facebook, and Amazon, (which may lead to even greater tension with the United States) but the tax also may lead to such companies reducing their services in the European Union.

If the European Union should decide to introduce a digital tax, it is important not to forget that E.U. legislation on tax matters requires unanimous approval by the member states. Since at least 110 countries are currently considering introducing a digital tax, the ultimate goal may be to regulate digital taxation at the OECD level. Germany is also leaning toward this proposal at present.⁶³ As the introduction of such a tax by the European Union or the OECD will not take place within the foreseeable future, a number of E.U. member states (such as Spain, Italy, and the United Kingdom) are considering venturing out on their own.⁶⁴

Some commentators fear that introducing a digital tax would result in a high cost of implementation and execution. Simultaneously, they fear the resulting tax revenues would be relatively low as the number of companies to which it would apply would be quite low. Relying entirely on estimates provided by the E.U. Commission, Germany estimates it would generate annual tax revenues of EUR 600 million.⁶⁵ Some see this as bad business for Germany. Regardless, it has become clear that introducing a digital tax would require a fundamental change to double taxation treaties—namely, the concept of "virtual establishments" would need to be introduced. Virtual establishments are not yet covered in any double-taxation treaty.

One question that remains open for discussion is whether the concept of digital taxation even fits into the picture of international tax standards. It is clear that a new digital tax from the European Union should not be the answer to other countries' taxing regimes, as fiscal sovereignty should not be compromised.

62. Vorschlag für eine Richtlinie des Rates [Proposal for a Council Directive], Deutscher Bundesrat: Beschluss des Bundesrates [BR] 94/18, [https://www.bundesrat.de/SharedDocs/drucksachen/2018/0001-0100/94-18\(B\).pdf?__blob=publicationFile&v=1](https://www.bundesrat.de/SharedDocs/drucksachen/2018/0001-0100/94-18(B).pdf?__blob=publicationFile&v=1) (Ger.).

63. *Wir sind uns einig in dem Ziel, die Steuervermeidung multinationaler Konzerne zu beenden*, BUNDESMINISTERIUM DER FINANZEN, November 12, 2018, <https://www.bundesfinanzministerium.de/Content/DE/Interviews/2018/2018-11-12-spiegel-online.html>.

64. *Grauzone-Europa: Scheitert die EU bei der 3-Prozent-Steuer?* WALL STREET ONLINE, Nov. 07, 2018, <https://www.wallstreet-online.de/nachricht/10993434-digitalsteuer-grauzone-europa-scheitert-eu-3-prozent-steuer>.

65. DANIEL BUNN, A SUMMARY OF CRITICISMS OF THE EU DIGITAL TAX, 1 (Tax Foundation ed., 2018).

VII. Italy

Italy has decided not to wait for actions at an international or E.U. level and unilaterally enacted domestic provisions to tax income from digital businesses that could be considered sufficiently connected with the Italian territory.⁶⁶ In fact, with the Budget Law 2018,⁶⁷ Italy introduced a domestic tax on digital transactions, which is referred to as the Web Tax, which differs from the E.U. web tax proposal and is expected to become effective as of January 1, 2019.

In particular, the Italian Web Tax is applicable to digital transactions having the following features: (1) supply of services via electronic means (internet or other networks), where services are deemed to be provided electronically if their supply is by nature automated via the use of information technology and minimal human intervention; (2) involvement on both sides of the transactions, of Italian residents, or Italian PEs of non-residents earning business income (B2B destination principle);⁶⁸ and (3) the volume of transactions must exceed 3,000 units for a specific service provider/taxpayer within a given calendar year. Where the above conditions are cumulatively met, the Italian Web Tax is levied at 3 percent rate excluding VAT.⁶⁹ A ministerial decree will identify the “services supplied through electronic means.”⁷⁰

Budget Law 2018 also amended the definition of permanent establishment contained in the Italian Tax Code⁷¹ by incorporating the recommendations of the OECD BEPS project.⁷² In particular, the amendment introduced an anti-avoidance provision under which a permanent establishment is deemed to exist in Italy where there is a significant and continuous economic presence. As a result, the domestic notion of permanent establishment has become significantly wider, thereby increasing a foreign enterprise’s business income probabilities to tax liability in Italy.

66. Piergiorgio Valente, *The Italian Web Tax from a National and International Perspective*, 5 EUROPEAN TAX’N 186 (2018), https://online.ibfd.org/kbase/#topic=doc&url=/highlight/collections/et/html/et_2018_05_it_1.html&q=%2522web%2522&WT.znav=Search.

67. Legge 27 dicembre 2017, n. 205, G.U. Dec. 29, 2017, n. 302 (It.), art. 1 (1011), <http://www.gazzettaufficiale.it/eli/id/2017/12/29/17G00222/sg>.

68. The place where the transaction is carried out is not relevant (L. n. 205/2017, art. 1(1013) (It.)); *see also supra*, note 32.

69. L. n. 205/2017, art. 1(1013) (It.).

70. *See Recent Developments in International Taxation*, INTERNATIONAL BAR ASSOCIATION (May 2018), <https://www.maisto.it/content/file/taxalert/2018-01.pdf>.

71. Decreto Presidente della Repubblica 22 dicembre 1986, n. 917, G.U. Dec. 31, 1986, n. 302 (It.), art. 162(2)(f-bis).

72. *See* OECD, PREVENTING THE ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT STATUS, (OECD Publishing ed., 2015), <http://www.oecd.org/ctp/preventing-the-artificial-avoidance-of-permanent-establishment-status-action-7-2015-final-report-9789264241220-en.htm>.

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VIII. Japan

A. SUMMARY OF JAPANESE DIGITAL TAXATION

Japan thus far has taken no unilateral action to tax digital activities or to expand the tax base to capture digital presence for the purpose of income taxation. But in 2015, Japan introduced the Consumption Tax (VAT) to digital services including e-books, online music, and videos provided by non-Japan resident service providers.

B. JAPANESE PERSONAL INCOME/CORPORATE TAXATION ON DIGITAL ECONOMY

Japan has yet to take any legislative action to tax digital presence for the purpose of taxation on income of individuals or corporations. Namely, the Japanese tax law has maintained the traditional concept of “permanent establishment” and a series of conventional source rules in line with the OECD Model Tax Convention.⁷³

For example, with respect to a computer server located in Japan, there were arguments that users’ income should be attributed to the server, which would be deemed as foreign users’ permanent establishment. However, the Japanese tax authority’s position regarding the co-location services for high frequency trading, published by the Tokyo Stock Exchange, provides that non-Japan-resident investors are *not* deemed to have a permanent establishment in Japan solely based on the fact that they place and reserve data for a computer program in a server located in Japan and implement that program for making selling/purchasing orders⁷⁴ The Japanese tax authority points out that the server is not (a) for sale or otherwise at the disposal of, or (b) for sublease or otherwise for any profitable use for, foreign investors, and thus is not viewed as a permanent establishment.⁷⁵

Still, the Japanese tax authority appears to be eager to capture digital presence. For example, in 2009, it was reported that the Japanese tax authority made adjustments with respect to certain Japanese affiliates of Amazon.com International Sales (Amazon US) because these Japanese affiliates constituted (either branch or agency) permanent establishments of Amazon US based on the finding that Amazon US’s computers were used in Japan, Japanese employees were instructed by Amazon US, and the Japanese

73. Nihon no shotoku zeiho [Japanese Income Tax Act] Law No. 33 of 1965, Articles 2(a)(viii-iv) & 161(1); Nihon no hojin zeiho [Japanese Corporation Tax Act] Law No. 34 of 1964, Articles 2(xii-xix) & 138(1).

74. *Tax Treatment of Foreign Investors Who Use Servers Located in Japan*, TOKYO STOCK EXCHANGE, June 16, 2011.

75. *Does a high-frequency trading server constitute a permanent establishment?*, NISHIMURA & ASAHI, Sep. 16, 2011, <https://www.internationallawoffice.com/Newsletters/Corporate-Tax/Japan/Nishimura-Asahi/Does-a-high-frequency-trading-server-constitute-a-permanent-establishment?redir=1>.

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affiliates functioned as more than mere logistics providers for Amazon US.⁷⁶ However, through a mutual agreement procedure, the US and Japanese governments reached an agreement in 2010, resulting in no significant tax expense for Amazon US.⁷⁷

Another example is one in which a US resident online car-parts vendor was viewed to have a permanent establishment in Japan, subject to the Japanese income taxation, for the reason that it rented an apartment and a warehouse in Japan. The roles and functions of the warehouse were essential and material for the sales activities of the US vendor. The tax adjustment was approved by the court.⁷⁸

When the OECD makes specific recommendations for taxing digital activities, possibly in 2020, the Japanese government is expected to move to enforce or take legislative actions in line with them.

C. JAPANESE CONSUMPTION TAXATION (VAT) ON DIGITAL SERVICES

Effective since October 1, 2015, cross-border digital services provided by non-resident providers to Japanese resident customers have been subject to the two-tiered regime of the Japanese Consumption Tax, which is equivalent to the European Value-Added Tax.⁷⁹ The first tier is for the business to business (B2B) transactions for which Japanese business customers/recipients are responsible for paying the Consumption Tax in Japan on behalf of the non-Japan service provider under the reverse charge mechanism. As the Japanese business customers/recipients are eligible for input tax credits in the same amount as the output tax on the condition that the non-resident service providers are registered with the Japanese tax authority, no actual payments result in most cases. Also, the scope of the applicable taxpayers is tentatively limited by the Act “for the time being.” The second tier is for the business to customer (B2C) transactions for which non-resident service providers are responsible for paying the Consumption Tax in Japan by appointing a paying agent in Japan. The current rate of the Consumption Tax is eight percent of gross revenue, but is scheduled to be raised to 10 percent on or after October 1, 2019.⁸⁰

The covered transactions are “services provided *through* telecommunications”⁸¹ or “electronic services.” “Electronic services” include e-books, digital newspapers, online downloading of music and videos, online games, cloud services, internet advertisements, and online

76. *Japan: Corporate Tax 2019*, ICLG (Nov. 16, 2018), <https://iclg.com/practice-areas/corporate-tax-laws-and-regulations/japan>.

77. Amazon.com, Inc., Quarterly Report (Form 10-Q) (Sep. 30, 2010).

78. *Japan*, EDIPLOMAT (July 2004), http://www.ediplomat.com/np/post_reports/pr_jp.htm.

79. Nihon no shohi-ho [Japanese Consumption Tax Act] Law No. 108 of 1998, Section 4(1)(3)(iii) & 5(1).

80. *Id.*

81. Nihon no shohi-ho [Japanese Consumption Tax Act] Law No. 108 of 1998, Section 2(1)(viii-ii)(viii-iii)(viii-iv).

schools. In contrast, “electronic services” do *not* include internet banking or software development (for which the completed product is delivered online), as these online telecommunications are merely ancillary or incidental to other off-line services.

IX. United States

Although the United States is participating in the OECD’s Inclusive Framework consultations in Paris on how best to address taxation challenges presented by the digital economy, top US officials have expressed “strong concerns” that the unilateral approaches now being considered by the E.U., and already effected in other jurisdictions, are wrong-headed. Responding to the OECD’s March Interim Report, US Treasury Secretary Mnuchin stated that,

the issues are not unique to technology companies, but also relate to other companies, particularly those with valuable intangibles * * * [and it would be] unfair [to impose a] gross sales tax that targets our technology and internet companies. A tax should be based on income, not sales, and should not single out a specific industry for taxation under a different standard. We urge our partners to finish the OECD process with us rather than taking unilateral action in this area.⁸²

In addition, the chair of the US House committee in charge of US tax legislation slammed the U.K.’s new cross border digital tax. “Singling out a key global industry dominated by American companies for taxation that is inconsistent with international norms is a blatant revenue grab.”⁸³

Somewhat ironically, on June 21, 2018, the US Supreme Court issued a landmark decision in *South Dakota v. Wayfair, Inc.*,⁸⁴ overturning the Court’s decades-old restriction⁸⁵ on the power of US states to assert sales tax jurisdiction over out-of-state sellers. The issue before the Court was whether South Dakota’s sales tax statute violates the Commerce Clause of the US Constitution, which requires out-of-state sellers to have “minimum contacts” with a state before the state can exercise its tax jurisdiction over the seller. South Dakota’s statute requires out-of-state retailers to collect, on the state’s behalf, sales tax on Internet sales to customers residing in South Dakota, even if the retailer has no actual, physical presence in the state.

In reviewing its 1992 decision in *Quill Corporation*—which had affirmed that a *physical presence* in the state was necessary and which was decided before Internet sales became widespread—the Court first found that “physical presence” is not the exclusive type of minimum contact that can establish the essential nexus between a state and a business. Additionally, the

82. *Netflix Set to Invest*, *supra* note 28.

83. Kevin T. Brady (@Rep KevinBrady), TWITTER (Oct. 31, 2018), <https://twitter.com/WaysandMeansGOP/status/1057643286863773696>.

84. *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018).

85. *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

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Court found that the physical presence test enunciated in *Quill* “creates rather than resolves market distortions” by putting in-state sellers at an “unjust and unfair” competitive disadvantage. Lastly, the Court found that the physical presence test is tantamount to a “judicially created tax shelter” imposing an “arbitrary, formalistic distinction” by requiring online remote retailers with an in-state warehouse to collect sales tax but allowing those without one to conclude similar sales without having to collect and remit the sales tax.

By holding that remote online retailers that sell to customers have established a sufficient nexus with a state, the Supreme Court extended US states’ taxing power with respect to *sales taxes*—an indirect consumption tax.⁸⁶ But its *Wayfair* decision does not affect states’ *income tax* jurisdiction, which is expressly restricted by federal statute—at least with respect to remote sellers of tangible property.⁸⁷ Nonetheless, *Wayfair* may embolden some states to mount judicial or legislative campaigns to repeal that federal statute in order to extend their *income tax jurisdiction* over remote online sellers.

The *Wayfair* decision’s impact on non-US online retailers could be immense. US states and smaller municipalities might now contend they can legally require foreign sellers with online customers in the US to collect and remit sales taxes to their jurisdictions (which number in the thousands). Tax treaties, which generally protect foreign sellers from income tax liability if the seller’s activities do not amount to a *permanent establishment* in the consumer’s country—which test is strikingly similar to the physical presence test—do not expressly apply to state and municipal taxes or to sales taxes. Without any treaty protection, foreign sellers of digital services—and, if the federal statutory restriction is changed, foreign sellers of goods, including digital goods—may find themselves subject to US state tax jurisdiction in the wake of *Wayfair*.

X. Other International Implications

Given the official US criticism of proposals to create a “digital permanent establishment,” it seems paradoxical that the US state tax statute, blessed as constitutional by the Court in *Wayfair*, shares key features with both the digital PE alternative described in BEPS Action 1 and the digital services tax (DST) now being considered by the E.U.⁸⁸ Under those digital PE provisions, an online business would have a permanent establishment in a country if it generates more than a threshold amount of revenue from that country, has more than a threshold number of users in that country, or concludes more than a threshold number of contracts with residents of such

^{86.} *Id.* at 2103; see also Thomas Ecker, *Digital Economy International Administrative Cooperation and Exchange of Information in the area of VAT*, in *VAT/GST IN A GLOBAL DIGITAL ECONOMY* 141 (Croydon: Kluwer Law International, Michael Lang & Ine Lejeune eds., 2015).

^{87.} Interstate Income Act of 1959, Pub. L. 86-272, 15 U.S.C. §§ 381–384 (1959).

^{88.} Smith-Meyer & Vinocur, *supra*, note 58.

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country. These criteria are comparable to South Dakota's statute, which also is based on the dollar amount or number of sales. The striking similarity of the US states' approach for taxing online transactions to those now being considered by both the E.U. and OECD casts doubt on how persuasively US Treasury officials will be able to argue that the world's tax authorities would be wise to not depart from the traditional PE definition and the more traditional models for determining the limits of nation states' taxing jurisdiction over remote sellers in the digital economy.

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