

Chapter 6. Interim measures to address the tax challenges arising from digitalisation

This chapter notes that there is no consensus on either the merit or need for interim measures with a number of countries opposed to such measures on the basis that they give rise to risks and adverse consequences irrespective of their design. Other countries acknowledge these challenges, but consider that they do not outweigh the need to implement interim measures and consider that at least some of the possible adverse consequences can be mitigated through the design of the measure. Countries in favour of the introduction of interim measures have set out guidance on the design considerations that need to be taken into account when considering the introduction of such measures.

6.1. Overview

403. Working towards the delivery of a consensus-based solution to the tax challenges arising from digitalisation as described in Chapter 5 will take time. In the interim a number of jurisdictions are considering the introduction of an interim measure.

404. There is no consensus on either the merit or need for interim measures and therefore this report does not make a recommendation for their introduction. A number of countries consider that an interim measure will give rise to risks and adverse consequences irrespective of any limits that may be imposed on the design of such a measure and therefore oppose any such measure. Other countries acknowledge these challenges, but consider that they do not outweigh the need to ensure that tax is paid in their jurisdictions on certain e-services supplied in their jurisdictions and consider that at least some of the possible adverse consequences can be mitigated through the design of the measure. This latter group is also of the view that a proliferation of different interim measures would be undesirable and that therefore it is preferable to set out guidance on the design considerations that need to be taken into account when considering the introduction of interim measures.

6.2. Introduction

405. As set out in detail in Chapter 2, a tax challenge raised by digitalisation relates to how some enterprises can now be extensively involved in the economic life of a jurisdiction with little or no taxable presence. An outline of the possible long-term approaches to address these issues, and the next steps in progressing that work, are described in Chapter 5 and Chapter 8 of this report.

406. Developing, agreeing and implementing a global solution will, however, take time, and, in some countries, there are pressing calls for governments to take more immediate action to address these challenges. The most immediate concern for these countries typically relates to those digitalised businesses that have a significant market presence, but have little physical presence, in the local jurisdiction and which have business models that rely heavily on intangible property, data, user-participation and network effects. A number of these jurisdictions are considering an interim measure in the form of an excise tax¹ on the supply of certain e-services within their jurisdiction that would apply to the gross consideration paid for the supply of such e-services by a registered e-services supplier. It is for this reason that this Section includes references to such an excise tax on e-services.

407. There is no consensus on the need for, or the merit of, interim measures with a number of countries being opposed to such measures irrespective of its design. These countries do not agree that features such as “scale without mass”, a heavy reliance on intangible assets or “user contribution” provide a basis for imposing an interim measure and further consider that there are a number of risks and adverse consequences that would arise in respect of such a tax including:

- **Impact on investment, innovation and growth:** As any tax on the supply of particular services, an interim measure will increase the cost of capital, reducing the incentive to invest with a resulting negative effect on growth. A measure only applicable to digitalised sectors risks slowing down investment in innovation for those businesses that are subject to the tax or indirectly affected by it. Although the effect will also depend on the financing of the investment, without proper

constraints, like an exemption for SMEs a gross basis tax could effectively penalize start-ups and other growing firms with losses or limited profitability and provide a competitive advantage to mature profitable incumbents, helping to create a barrier to entry that cements the dominance of established firms.

- **Impact on welfare:** An additional hurdle with a tax on a gross basis is that it is equivalent to a tax on inputs. This implies that it is likely to distort firms' choices of inputs thus distorting production itself. In other words, when such a tax is introduced, either production could decline or more resources will need to be employed to reach the same level of production. Consequently, there is likely to be a negative impact on the overall welfare of an economy and on its output. The size of the effect will depend on elasticities of substitution and will be smaller the more targeted the measure is.
- **Potential economic incidence of taxation on consumers and businesses:** Depending on the price sensitivities of the seller and customers, and the structure of the market, the incidence of taxation could be fully or partially passed on to local consumers in the form of higher prices for goods or services. The lower the customers' price sensitivity and the more competitive the market the more likely it is that the burden of tax will be passed to the customer. This implies that, the less prepared customers are to stop buying a specific service or to shift to another, less taxed service, the higher the incidence of the tax on them. If services provided in a B2B context are subject to the same price sensitivities, the tax will result in a higher cost of inputs for other, non-taxable producers. This may also affect small businesses as users of such services even if the digital services they provide are excluded from the tax.
- **Possibility of over-taxation:** In order to comply with its international obligations, a country may be required to apply the tax to both residents and non-residents, and to limit any credit mechanism against other taxes. This may create issues of over-taxation, (for instance, payments for certain e-services may be subject to both an interim measure and corporate income tax) and run counter to the underlying narrative for the introduction of the tax, which is to target supplies of cross border digital services that are not subject to income taxation in the market jurisdiction under existing rules. Economic double taxation could also arise through cascading effects where a certain supply of e-services is made to a person that incorporates those services into an onward supply that is itself subject to the tax.
- **Possible difficulties in implementing a tax as an interim measure:** Taxes, once introduced, are often difficult to repeal and given the time that may be needed to develop and implement any interim measure, this raises the question whether it is worth introducing a completely new set of rules and related administrative procedures which may apply only for a limited period of time.
- **Compliance and administration costs:** An interim measure may give rise to compliance and administration costs that could be substantial relative to the amount of tax raised under the measure, particularly given that the measure is only intended to be temporary in duration. These compliance costs will be even higher to the extent countries adopt divergent unilateral measures. The taxing jurisdiction may also encounter difficulties in auditing and verifying the accuracy of the returns filed and payments made by non-residents.

408. Countries that are in favour of the introduction of interim measures acknowledge that such challenges may arise but consider that there is a strong imperative to act to

ensure that the tax paid by certain businesses is commensurate with the value they consider is being generated in their jurisdictions also noting the time discussions have already taken. These countries commonly take the view that user participation is a key driver of value for certain digital businesses in terms of contributing to the content of a platform, building network effects and providing data through their activities and sustained engagement. They believe that the international tax rules need to be reformed to take account of those value drivers in how profits of those businesses are allocated between countries for tax purposes. And, in the absence of such reform, they believe that there is a mismatch between taxable profit and value creation that challenges the fairness, sustainability and public acceptability of the system. For that reason, and in their recognition of the length of time it will take to achieve and implement a consensus based solution, these countries believe that there is a need to consider more immediate action (e.g. through a tax on certain supplies of e-services) that would be designed to compensate jurisdictions for what they consider to be unrecognised value created in their jurisdiction, pending a global solution based on consensus. These countries acknowledge that there are challenges associated with taxes imposed on certain e-services, however they think that those challenges need to be weighed against the policy challenge of not acting, and consider that at least some of the possible adverse consequences can be mitigated through the design of the measure. For example, the extent of the risk of over-taxation under the measure may depend on a number of factors including the scope of the tax, the tax rate, registration threshold, whether the expenditure on e-services is likely to constitute a deductible business expense, and any tax and expenditure measures outside the scope of the tax. Equally compliance and administration costs can be minimised by aligning tax filing and collection mechanisms with other taxes (such as those for VAT purposes in to cross-border supply of services to consumers) and by ensuring alignment with similar measures introduced by other countries.

409. Recognising these challenges, and acknowledging the uncertainty, cost and inefficiency that could result from countries adopting a multitude of different unilateral measures, the countries that are considering the introduction an interim measure believe there is merit in setting out guidance on the design considerations that need to be taken into account to limit the possible adverse consequences associated with any interim measure. The discussion on interim measures in this Chapter is without prejudice to the future discussion and development of long term solutions to the tax challenges raised by digitalisation.

410. It is for this reason that countries that are considering the introduction of interim measures have identified a number of considerations that they believe need to be taken into account by jurisdictions that are considering the introduction of this type of interim measure in order to provide these jurisdictions with guidance on ways to limit the potential for divergence and the possible adverse side-effects of such measures.

411. Jurisdictions and regional groupings considering the introduction of interim measures should carefully weigh the pros and cons of such a measure in light of their particular circumstances.

6.3. Considerations for the design of interim measures

412. Countries that are in favour of the introduction of interim measures recognise the need to take the following considerations into account: (i) be compliant with a country's international obligations; (ii) be temporary; (iii) be targeted; (iv) minimise over-taxation; (v) minimise impact on start-ups, business creation and small businesses more generally,

and (vi) minimise cost and complexity. Each of these considerations is considered in further detail below.

6.3.1. *Compliant with international obligations*

413. Any new tax that a country introduces must be in compliance with its existing international obligations. Countries will need to consider the wording of all their existing treaties and determine to what extent they would impact any interim measure. These obligations include those imposed by bilateral tax treaties as well as a country's obligations under trade agreements, including membership of the World Trade Organization (WTO) and obligations that flow from regional political and economic groupings such as the European Union (EU) and European Economic Area (EEA).

414. These constraints may place significant restrictions on the design options for any interim measure. In particular, a country's bilateral tax treaties may prevent the taxing jurisdiction from imposing a tax on income or any element of income, while a country's trade and other international obligations may impose further limitations, for example by requiring the tax to be applied to both residents and non-residents. These constraints and their potential impact on the design of any interim measure are described in further detail below.

Interim measure must not come into conflict with tax treaties

415. As set out in Chapter 5, under most tax treaties, business profits derived by an enterprise resident in one contracting state are, with some exceptions, taxable exclusively by that state unless the enterprise carries on business in the other state through a permanent establishment.² Tax treaties that are in line with the OECD Model Tax Convention on Income and on Capital (OECD, 2017^[1]) will, therefore, generally prevent countries from imposing a tax on the income derived by a non-resident on the supply of digital services if it is in the form of a tax that is covered by that tax treaty.

416. Article 2 (Taxes Covered) of the OECD Model Tax Convention provides that the Convention applies to "taxes on income" or on "elements of income", "irrespective of the manner in which they are levied". Additionally, Article 2 provides that the Convention will also apply to all new taxes that are identical or "substantially similar" to the taxes listed. The Commentary on Article 2 of the OECD Model Tax Convention provides that the objective of Article 2 is "to widen as much as possible the field of application of the Convention by including, as far as possible, and in harmony with the domestic laws of the contracting States, the taxes imposed by their political subdivisions or local authorities, to avoid the necessity of concluding a new convention whenever the Contracting States' domestic laws are modified, and to ensure for each Contracting State notification of significant changes in the taxation laws of the other State."³

417. Given this wide application, in this context it may not always be clear whether a tax is covered by tax treaties or not. What may help distinguish taxes on income, or on elements of income, from other taxes is that, on a conceptual level at least, taxes on income focus on the recipient of the income rather than on the consumer of a supply of specific goods or services. Indeed, an income tax is usually explicitly imposed on the recipient of the income, and looks at the characteristics and the economic situation of the recipient of a payment.

418. While the tax base of an income tax is generally the net income of a taxpayer, the lines can be blurred in practice in case of a tax on a gross amount of income. For

example, a withholding tax on a gross payment of royalties charged in the country of the payer would generally be deducted by the payer from the consideration paid for the use of intellectual property and would be creditable against the recipient's income tax liability in the recipient's own country.

419. While an income tax is generally perceived as imposing the burden on the recipient in respect of its income, in determining whether a tax is a covered tax under Article 2, it makes no difference whether taxes are levied by way of withholding at source, or whether the tax is on a net or a gross amount. Nor does the method of its assessment or the manner of collection under domestic law matter.

420. Article 2 applies not only to taxes on income, but also to taxes on elements of income. An interim measure that taxes an element of income and that is linked to the characteristics or economic situation of the recipient, for example, the profitability of the supplier, runs the risk of being a covered tax within the purview of Article 2. Conversely, an interim measure would more likely not be considered a covered tax where it is imposed on the supply itself, rather than the supplier, and where it focuses exclusively on the expenditure side of the payment - that is to say, the nature and value of the supply. The mere fact that the tax may be collected from the supplier and that there is a threshold that must be met before a person is required to register and account for the tax will not generally be sufficient to bring the tax within the scope of the Convention.

421. As stated above, a tax that is covered by tax treaties is generally one that is focusing on the supplier, rather than on the supply. Further, the case that an excise tax on e-services is not a tax on income that tax treaties intend to cover would be stronger where it is:

(i) levied on the supply of a certain defined category or categories of e-services and imposed on the parties to the supply without reference to the particular economic or tax position of the supplier; (ii) charged at a fixed rate, calculated by reference to the consideration paid for those services (without reference to the net income of the supplier or the income from the supply); and (iii) not creditable or eligible for any other type of relief against income tax imposed on the same payment.

422. An excise tax will not be expected to be covered by the OECD Model Tax Convention (with the exception of some articles such as those on the exchange of information, assistance in the collection of taxes, or non-discrimination) provided the tax is not (either as matter of form or substance) a tax on income or any element of income. The name of the tax is not determinative, and Article 2 of the OECD Model Tax Convention could cover taxes that are badged as excise taxes but which are, in substance, income taxes. An excise tax on a particular type of payment may not be very different from a tax on the gross payment of royalties or fees for services under the domestic law of some states. Also, many bilateral treaties deviate from the definition in the OECD Model Tax Convention and it is therefore difficult to state in the abstract when a tax is within the scope of a particular tax treaty. While most tax treaties follow Article 2 of the OECD Model Tax Convention, a good number deviate from it, most commonly by omitting the first two paragraphs. That means that the scope of Article 2 is defined by taxes listed in paragraph 3 and by the extension to new taxes under paragraph 4.

423. Whether an interim measure falls within the scope of a particular tax treaty is a determination that must be made by each country based on the precise features of the interim measure and wording in the relevant tax treaty. Countries will need to consider the wording of all their bilateral treaties to determine whether, and to what extent, this might impact on the design of any interim measure.

424. A tax that does not come within the scope of tax treaties would not be expected to be creditable against income tax imposed by the jurisdiction of residence of the taxpayer and would not be required to be credited under any tax treaty with that jurisdiction.

(a) Applying the interim measure to non-residents will not generally give rise to discrimination under bilateral tax treaties

425. Although tax treaties generally apply only to taxes on income (or on an element of income), some provisions also apply to other types of taxes, such as the non-discrimination article. A measure which applies only to non-residents should not, however, give rise to issues under the non-discrimination provisions that are equivalent to those found in Article 24 of the OECD Model Tax Convention, except as discussed below.

426. Article 24 of the OECD Model Tax Convention deals with the elimination of tax discrimination in precise circumstances. The Article and the Commentary recognise that the distinction between residents and non-residents is a normal and common feature of income tax systems and should be respected. It is normal, for example, to impose withholding taxes on gross payments of interest or dividends made to non-residents, while residents are not subject to such tax; residents, however, are typically subject to net basis taxation on such income. In particular, Article 24(1), which prohibits discrimination on the grounds of nationality (e.g., citizenship or incorporation), provides that nationals of one state may not be treated less favourably than nationals of that other state “in the same circumstances, in particular with respect to residence”. This makes it clear that the residence of the taxpayer is one of the factors that is relevant in determining whether taxpayers are placed in similar circumstances. A taxpayer who is not a resident of a Contracting State is not considered to be the same circumstances as a person who is a resident of that State and therefore taxation outcomes may be different. Tax measures that limit the deductibility of certain payments made to non-residents are, however, subject to the non-discrimination provision under Article 24(4) of the OECD Model Tax Convention, but this provision does not apply in the case of an interim measure which does not restrict the deductibility of interest, royalties or other disbursements (or the deduction of debts for capital taxes).

(b) Membership of EU and EEA

427. For Member States of the European Union and parties to the Agreement on the European Economic Area (EEA Agreement), an interim measure must be in compliance with EU law including the fundamental freedoms set out in the EU treaties and the prohibition on State aid.

428. In order to ensure that the measure does not restrict the freedom of establishment, or the freedom to provide services, it should therefore apply equally to both resident and non-resident taxpayers. Any design element that had the effect of discriminating between residents and non-residents would only be compliant with these freedoms if it were justified by and proportionate to one of the few justifications recognised by the European Court of Justice in the context of direct and indirect taxation.

429. In order to ensure that the measure is not impermissible State aid when applied by individual jurisdictions, the measure would need to be designed not to provide a selective advantage to any group of taxpayers. In other words, an interim measure would need to avoid different treatment of undertakings that are in a legally and factually comparable position.

430. For countries that are EU members, the interim measure should also be designed such that it is not a value added tax that would be inconsistent with the EU Directive on the Common System of Value Added Tax.

(c) Membership of WTO

431. Any interim measure should also take into account other existing international obligations, including those relating to membership of the WTO. These obligations include non-discrimination requirements relating to national treatment and most-favoured nation provisions.

Temporary

432. Any interim measure should be introduced recognising the policy intent of it being temporary; ceasing to apply once a global response to the tax challenges raised by digitalisation has been agreed and is implemented. This follows from the very policy rationale that justifies the introduction of an interim measure. It also reflects the consensus among all Inclusive Framework members that a comprehensive global solution is to be preferred over the adoption of unilateral measures whether implemented individually, or collectively at the regional level, for example in the EU context.

433. It is essential that countries maintain a commitment to achieve a broader global consensus and ensure that, once a global solution is found, it can be implemented in a swift and coordinated manner and that the interim measure remains purely that, without undermining or jeopardising global action. Where a country has already adopted an interim measure, such measure should operate on a similar understanding.

Targeted

434. Given the potential adverse consequences of introducing an interim measure, it is important that the measure is as targeted as possible at those businesses that are perceived to constitute the highest risk, which for a number of countries are those businesses that combine high levels of scale without mass, and have business models that rely heavily on user participation and network effects. As the interim measure is not intended to provide a comprehensive solution, it should not seek to cover any and all transactions where the increase in digitalisation poses some risk or could be seen to pose some risk.

435. The scope of the measure should be well-defined and targeted so to improve compliance and administration, and to minimise the collateral impact of the measure on other elements of the domestic and international tax system.

436. The interim measure should not apply to supplies of physical goods where the supplier is simply the owner of the goods transferring title in those goods to the seller under a contract that is concluded online. The online sale of goods can be contrasted with intermediation services, discussed in further detail below, where an online intermediation platform facilitates the exchange of physical goods between third parties. Given the importance of physical infrastructure to the sale of physical goods (including inventory management, warehousing and logistics) and the recent work under Actions 7 to 10 of the BEPS Project, this business model is not one that presents the sort of risks that should lead to the introduction of an interim measure. Also, the implications of imposing an interim measure on supply of goods would be extremely far-reaching and certainly beyond what should be the subject of an interim measure as it would, for instance, cover the online sale of groceries from the local supermarket.

437. The interim measure should also be restricted to certain specified e-services and not apply to all services simply on the basis that they are provided over the internet. Such a broad definition of e-services would capture businesses, where, as set out in Chapter 2, the intensity of user participation is relatively low. An excise tax that applied to a wide range of businesses with significant variation in profitability and different degrees of digitalisation may well have a more disruptive and unpredictable impact on the domestic economy, which may undermine innovation and growth in the supply of digital services and solutions.

438. A broad interim tax on all e-services may also give rise to ambiguities and anomalies which could give rise to unanticipated compliance and administration costs as well as planning opportunities. For example, it may be difficult to determine whether a particular service has been provided through the internet in those cases where the e-services provider has other ways of communicating with its customer. A broad tax on all e-services may also result in different tax treatment depending on whether the underlying supply is made in physical or digital form. For example, a tax that applied to all online services, but not to the online sale of goods, would tax the online delivery of music, software, films and other copyrighted material, but would not apply to the delivery of the same products in tangible form (i.e. CD's, Disks or DVDs). Finally, a broader scope could also exacerbate cascading and over-taxation problems.

439. A number of countries maintain that a targeted interim measure could focus on internet advertising and digital intermediation services because they perceive that these categories of e-services businesses typically operate remotely and rely heavily on intangible property, data, user-participation and network effects and believe that therefore value is being created in their jurisdiction.

(a) Internet Advertising

440. Internet advertising is a well-recognised and ubiquitous service that has expanded rapidly as a consequence of digitalisation. It is a service that can be provided remotely, without the service provider needing to establish a taxable presence in the jurisdiction to which the advertising is targeted. As discussed in Chapter 2, internet advertising is characterised by strong network effects and is typically reliant on exploiting data that is collected through user participation.

441. A tax on internet advertising would apply to the service of delivering a specific advertising or promotional communication through the internet to an end-user. The tax would only apply to paid advertising or promotion. The tax would apply, for example, to a website provider that charges other websites for promoting links to their site or where a product manufacturer pays an advertising agency or social media platform for placing an advertisement for that product on the platform. It would not apply, however, to a user of a social media platform who uploads a photo or video of promotional material unless the platform actually charges the user for posting that content.

442. An issue that may arise in the scoping of an excise tax for online advertising is determining the extent to which the consideration paid for a composite supply is attributable to an online advertising component. For example, tax administrations would need to clarify whether advertising in a printed publication should be treated as the supply (or part supply) of an e-service, when the publication was also made available to readers online. Jurisdictions may further need to consider anti-avoidance rules to prevent companies re-characterising their services in order to avoid the tax, for example by

changing the legal characterisation of the services supplied without affecting the substance of the services performed.

(b) Intermediation services

443. Digital intermediation services (also referred to as platforms) are websites and mobile applications that facilitate the exchange of goods or services between third parties. Intermediation service providers typically depend on active user participation and indirect network effects to create a virtual market place. The definition of e-services would include any type of virtual market place that permits third parties to trade or exchange goods or services. It could include, for example, multi-player online games to the extent they facilitate the exchange of services within the game. Countries may consider excluding from this definition platforms that facilitate the provision of financial services (such as lending, insurance or trading in securities or commodities) as the regulatory environment and the related tax implications for providing such services may justify taking such services outside the scope of an interim measure. Also, specific financial transaction taxes (such as stamp duty) may already apply to these kinds of services.

444. This category of e-service would only include the intermediation of transactions between third parties in return for consideration and would not include direct online sales of services made directly to customers through the vendor's own website. For example, a website that allows travellers to make online bookings of flights and accommodation with third party airlines and hotels could be treated as providing intermediation services and the excise tax could apply to any commission paid by the airline or hotel in respect of each booking made through the site. If, however, the flight or accommodation is booked directly with the airline or hotel through its own website, then there would be no supply of intermediation services and the excise tax would not apply.⁴ Apportionment between taxable and non-taxable supplies may be required where only part of the service is intermediation services.

445. Like advertising services, online intermediation services are a well-recognised and ubiquitous service that is generally provided remotely, without the service provider needing to establish a physical presence in the jurisdiction where the services are sold or performed. Also, if only internet advertising was covered, there may be some businesses that could reconfigure their business model into an intermediation service. However, some intermediation services involve lower levels of user participation than others (for example where the product or service is generic and fungible and there are a limited number of potential customers and/or suppliers). Compared to internet advertising business models, intermediation services business models vary more widely in terms of their reliance on direct and indirect network effects. Some intermediation platforms would appear to rely primarily on indirect network effects, with little role for direct network effects, and with user contributions less 'active' and less critical to the functioning of the business model. An excise tax could create a tax preference for vertically integrated businesses compared to online platforms and it might encourage intermediation service providers to change their business model and terms of service in order to escape the tax. A tax on intermediation services may also have an impact on those smaller businesses that rely on intermediation services as a way of getting their goods and services to market. Countries should therefore carefully weigh the pros and cons of extending the scope of any interim measure to intermediation services.

Minimises over-taxation

446. A key objective of an interim measure should be to balance the underlying policy objective of trying to address the rapidly emerging challenges raised by the digitalisation of the economy while avoiding the risk of over-taxation on taxpayers caught by the measure. Both the rate of tax and the scope of the measure will be important factors in achieving this balance. In particular, the broader the scope of the measure the more likely it would be to result in over-taxation of certain taxpayers, thereby undermining the original rationale for the measure. The rate should be set at a low rate that is proportionate to the profit margins of the businesses that it is to apply to. Setting the tax at an appropriate rate is more challenging if the tax is applied on gross payment basis and, in practice, it will be even more difficult if the measure applies to a wide range of services and service providers. E-services businesses will have different profit margins, cash-flow and credit costs which, depending on the rules that govern the accounting of payments and filing of returns, may result in the tax having an unpredictable and disproportionate impact on certain e-services businesses.

447. Where an interim measure takes the form of an excise tax on the gross amount for the supply it has the potential to result in economic double taxation. As noted above economic double taxation may arise due to the fact that the excise tax is applied to both residents and non-residents with no ability to credit the tax against corporate income tax levied on the same payment. This outcome may appear counter-intuitive given that a key driver for an interim measure is the ease with which a non-resident can supply e-services in the taxing jurisdiction without having any taxable presence.

448. Another type of double taxation can arise in those cases where a supply of e-services is made to a person that incorporates those services into an onward supply that is subject to the excise tax under domestic or foreign law. The extent of this cascading problem will depend on the design of the tax, including scope of the tax, the tax rate, registration threshold. It may be difficult to address any cascading effects without making changes to the design of the tax or affecting the way the e-services provider supplies those services in the taxing jurisdiction resulting in additional administration and compliance costs.

449. One mechanism for addressing this cascading effect would be to provide an exemption from the excise tax where the supplier can prove (certify) that the e-service will be used in an onward taxable supply. Countries' experience, however, with this type of mechanism (e.g. in a retail sales tax context) shows that it can be difficult to apply in practice, creates considerable opportunities for fraud and may not address all the double taxation effects from cascading. Equally the alternative of allowing the recipient of the supply to claim a credit for the excise tax paid by the supplier would have the effect of bringing the interim measure closer to a VAT and is likely to result in further and undue complication to the design of the tax, particularly given the temporary nature of the measure.

Minimises impact on start-ups, business creation, and small businesses more generally

450. The design of an interim measure will also need to be calibrated to limit any undue impact on business creation arising from digitalisation, noting the positive impacts that digitalisation has had on economic growth and productivity (described in Chapter 2 on business models and value creation). The concern that an interim measure may make certain businesses economically unviable will be particularly relevant in the case of start-

ups (and small businesses more generally) where financial constraints are likely to be tighter than for larger and more mature businesses. Small businesses may also indirectly be affected as they might be significant users of digital services. This risk will be further exacerbated where the tax is imposed on a gross payment basis.

451. Related to this consideration is recognition that an interim measure will also create compliance obligations that will place an indirect economic burden on business. At the early stages of business creation, such costs may be large and the revenue generated from the tax may be small. Further, this may be true notwithstanding best efforts to ensure the design of an interim measure that is simple to implement and administer, and as such, highlights the importance of not inhibiting start-ups, business creation and small business more generally.

452. Thus, an interim tax measure would need to have a threshold. The threshold needs to be designed and set such that it does not inhibit start-ups, business creation and small business more generally but it should not otherwise provide benefits for or discriminate against particular groups of taxpayers. It also needs to recognise that smaller firms are less able to shoulder compliance costs and that profitability levels better able to support an excise tax in both the internet advertising and intermediation market will typically only come with larger revenues. Cost and compliance considerations for tax administrations further support the case for a meaningful threshold. Any threshold should be set by reference to the results of the previous accounting period in order to promote certainty in the application of the threshold.

453. One approach that may meet these principles would be to apply a gross revenue threshold for the group as a whole combined with a local country sales threshold. Only digital service providers that exceed both thresholds would be required to register for the tax. An alternative approach that may meet these principles could be to only apply a local country sales threshold.

454. The gross revenue threshold provides a bright-line test for businesses that do not have a significant global presence. It would mean that smaller businesses entering the domestic market would not need to track their level of sales in each taxing jurisdiction in order to determine whether they were subject to the interim measure. Equally, it would make the administration of the tax easier for tax authorities. Countries could look to well-established international standards for setting the revenue threshold such as the threshold for Country by Country (CbC) reporting. While the CbC group revenue threshold of EUR 750 million was not designed for this purpose, it would have the advantage of being a known standard that is administratively simple for tax administration and taxpayers to apply. A gross revenue threshold would also provide certainty to those businesses whose operations fall below such a threshold that they will not be subject to such measures.

455. The gross revenue threshold would be combined with a local sales threshold which would exclude those e-service suppliers with a low level of supplies of e-services in a particular jurisdiction or geographic market, where the costs of administration and compliance are likely to be too great to justify the imposition and collection of a tax. A low level of sales would also be indicative of only small or negligible user participation and related network effects inside the sales jurisdiction.

456. For the purposes of determining whether the sales threshold has been met, the e-service providers would be required to aggregate their sales in scope of the interim measure with those made by other members of the consolidated group and anti-avoidance

rules may be required to address artificial or resale arrangements with non-group members designed to avoid any local sales threshold.

Minimises cost and complexity

457. Compliance cost for taxpayers and tax administrations should always be a key consideration in tax policy design. This is especially true for interim measures which will by definition be temporary and where administrative cost and complexity should be kept to a minimum. Aspects relating to administrability should be included in the design phase and given an important weighting in the scoring process for any measure under consideration. Administrability may argue, for instance, for relying in substantial part on existing tax collection mechanisms and procedures such as those developed for value added or sales taxes. It would further argue for a limited and targeted scope as well as meaningful threshold levels at which the measure applies.

458. In particular, an interim measure in the form of an excise tax on e-services would require a common place of supply rule that determines whether the supply of e-services has been made within the taxing jurisdiction. A consistent approach to determining the place of supply for e-services is important for reducing uncertainty, cost and inefficiency that would otherwise result from countries adopting these types of interim measures with different place of supply rules. The most appropriate rule for determining the place of supply in respect of such an interim measure will depend on the type of e-services covered by the measure.

a) Advertising services supplied in the jurisdiction where the advertising is targeted

459. In the case of advertising services, there are a number of reasons for treating the supply as made in the jurisdiction where the advertising communication is targeted:

- i. As a matter of substance, the advertising content is provided in the jurisdiction where the person accessing or viewing it (the end user) is located (rather than the jurisdiction of the purchaser of the advertising services).
- ii. Treating the place of supply as where the content is delivered will also mean that the excise tax cannot be avoided simply by acquiring the advertising services through an entity in a jurisdiction that does not impose an excise tax on e-services.

460. In addition it could be expected that on-line advertisers will usually have the mechanisms in place to collect and report information on the number and location of views of a particular advertising communication, and in many cases they may use this information for billing purposes. The fact that many online advertisers can be expected to already have these information collection mechanisms in place should make it easier for online advertisers to comply with, and tax authorities to administer, the interim measure.

461. Countries seeking to implement an interim measures on advertising services may look to some of the elements in the key principles set out in the International VAT/GST Guidelines which describe the kinds of information a supplier may rely on in order to determine the place of taxation for B2C supplies. These principles encourage jurisdictions to permit suppliers to rely, as much as possible, on information they routinely collect in the course of their normal business activity, as long as such information provides reasonably reliable evidence of the customer's location.

462. While not all online advertisers will hold information on the location of the end users as described above, they will generally know the IP address that was used to view the advertising content and may have other information on the end user (which could, for example, include information on the preferred language of the end user and the predominant place of access/viewing) which could assist in determining the end user's location.

b) Intermediation services treated as supplied in jurisdiction where the customer of the intermediation service is located

463. Although the virtual market place created by intermediation services has no physical presence, one approach would be to tax the commission earned from sales that take place in the market where the underlying sale occurs. While it may be difficult, in certain cases, for an intermediary to determine where the underlying supply of goods or services took place, a reliable proxy can be found by looking to the location of the customer. In the case of intermediation services, the customer would then be treated as the person that contracted for the supply of the intermediation services. Thus in the case of hotel booking websites, where the commission for the intermediation service is generally paid by the hotel, the supply would then be treated as made to the hotel. Similarly, in respect of the sale of goods where the seller pays a commission to the e-service provider in respect of every sale, the intermediation service would then be treated as supplied to the seller of the goods (and, in this case, the country of residence of the goods supplier would impose the tax, and not the country of residence of the goods buyer). In those cases where the service provider charges separate fees to different parties with respect to different sides of the same transaction (e.g. in the case of an intermediation service, both the seller and the purchaser of the intermediate goods or services) then the supply would be treated as made in proportion to the consideration provided.⁵

Notes

¹ Some countries refer to this as an equalisation tax or levy.

² As noted in Chapter 5, the OECD Model Tax Convention provides specific rules for certain types of income such as income from immovable property, interest, dividends, or royalties. However, none of these categories would be applicable in the case of tax on e-services.

³ For more background on the scope of Article 2 see (Working Party No. 3 of the Fiscal Committee, 1957^[2])

⁴ The question of whether a person is selling goods or services directly or providing intermediation services would need to be determined by looking to the substance of the arrangement as reflected in the agreements between the relevant parties to that supply. A web-based re-seller of third party goods may be treated as providing third party vendors with an online sales platform (i.e. an e-service) if the contractual arrangements between the parties indicate that the re-seller takes no inventory risk on the ownership of the goods sold through the website. Similarly an online content provider could be treated as providing an online sales platform for copyright holders to sell or license their content direct to users if, in practice, the provider has only a limited involvement in determining or controlling the content that will be made available through the platform and the licensing arrangements with copyright holders are substantially the same as a fixed commission arrangement.

⁵ In determining whether intermediation services have been supplied in a particular jurisdiction, particularly those cases where a customer may be established in more than one jurisdiction, countries may consider adapting the approach set out in the International VAT / GST Guidelines for B2B supplies and treating the supply as made in the jurisdiction where the establishment using the service or intangible is located.

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