The Digital Agenda, International Taxation and the Challenge of Base Erosion and Profit Shifting (BEPS).

New opportunities to stop illegal cross border operations?

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Over the last two decades, globalization has led to a significant integration in national economies, in no small part due to rapid technological evolutions in telecommunications. Indeed, the internet has changed the way most companies do business: their potential customer base has grown from national or regional to spanning a whole continent or even the globe; shifts in back-office operations have taken place as part of cost-arbitrage; marketing and/or offering products and services through social media has grown exponentially, and so on. Together with these developments a host of novel regulatory challenges have arisen for governments and regulators, whereby they must balance public policy objectives with reaping economic benefits from the digital economy.

In this article, we will briefly draw your attention to an important recent development in which many countries and international organisations are seeking to attain that balance. Namely, the financial crisis of 2008 laid bare that as the economy became more globally integrated, so did corporations. While multi-national enterprises represent a large proportion of global GDP, their transnational supply-chains may pose difficulties to 'legally capture' by any one jurisdiction. An area where this poses distinct problems is international taxation. The digital economy and economic integration has created new and significant opportunities for global enterprises to optimize and thereby possibly minimize their tax obligations. However, as governments have had to pay significant amounts to stem the collapse of the global financial system, reports that global corporations pay extraordinarily low effective tax rates have caused a significant public backlash. As a consequence G20 Finance ministers called on the Organisation for Economic Cooperation and Development (OECD) to take initiatives against what is known as "Base Erosion and Profit Shifting" (BEPS) In short, BEPS consists of sophisticated, global and aggressive corporate tax planning in order to create no or low taxation. In general terms, this is achieved through artificially segregating taxable income from the activities that generate it. In 2013, the OECD adopted its action plan to tackle BEPS, the implementation of which is now ongoing.

The relevance for Gambling and Lotteries is evident: As private and public entities move into the online world, governments will be and are being confronted with the question of financing and taxation. Insofar as revenues contribute directly to good causes, or indirectly through corporate taxation, globalization and digitalization in the gaming sector will have its impact as in any other eco-

... Continued on page 89

nomic sector. BEPS and its implementation will raise significant question marks over how the sector should approach the issue. In our view, notably the public—private divide is likely to be of importance: entities under significant state control are unlikely to engage in BEPS in a fashion that brings them into the so-called grey zone (and beyond). State control guarantees that such situation is not going to occur.

However, globalized private entities without far-reaching sovereign control are less constrained to engage in fiscal arbitrage, raising questions for governments on how to deal with the fact that the offer of gambling services in their jurisdictions may generate very little revenue.

In 2013 the OECD adopted its action plan on BEPS consisting of fourteen distinct actions. While all are certainly relevant, we may note in particular the following initiatives that will have an impact for the gambling and lottery sector: action 1—address the tax challenges of the digital economy; action 7—prevent the artificial avoidance of permanent establishment status; and actions 8,9 and 10—assure that transfer pricing outcomes are in line with value creation.[1]

Action 1 is a generalized initiative that focuses on the fact that BEPS and the digital economy raise distinct questions. Notably, the business models are different from traditional goods-based value chains, and there is a different understanding of the generation of value in this sector. As a consequence, the BEPS action plan will, under action one, look among others at the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international tax rules, but also at the attribution of value created from the generation of marketable location-relevant data, and the characterization of income derived from new business models.

Action 7 in the BEPS action plan aims to develop changes to the definition of Permanent Establishment (PE) in order to avoid and prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements compared to traditional distribution. The objective of such arrangements is sometimes to shift profits out of the country where the sales take place without a substantive change in the functions in a country.

Actions 8, 9 and 10 in the Action plan relate to transfer pricing, and aim to ensure that its outcomes are in line with value creation. Transfer pricing rules serve to allocate income earned by a multinational enterprise among those countries in which the company does business. Current transfer pricing rules aim to effectively and efficiently allocate the income of multinationals among taxing jurisdictions. Certain rules, however, are prone to specific application whereby income from economic activities that produce that income, are shifted into low-tax environments. Notably, action 8 will aim to develop rules to prevent BEPS by moving intangibles among group members, which includes ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with value creation.

At present, one year has passed since the adoption of the OECD BEPS Action Plan. On 26 September 2014, almost 300 senior tax officials from more than 100 countries met during the 19th Annual Global Forum on Tax Treaties to discuss base erosion and profit shifting. At this meeting they examined the 2014 deliverables, namely a first set of tax treaty-related recommendations developed under the OECD/G20 BEPS project.

Notably, on 16 September 2014 the OECD published its report on action 1: BEPS issues in the digital economy and how to address them.[2] The 202-page report found that while the digital economy does not generate unique BEPS issues, some of its key features do exacerbate the risks. In particular, a number of structures create additional opportunities to reduce and even eliminate tax in jurisdictions along the whole supply chain, including in market and residence countries.[3] The report notes that the importance of intangibles in the context of the digital economy, combined with their mobility for tax purposes under existing rules, generates significant opportunities for BEPS in the area of direct taxation. Furthermore, the fact that digital enterprises can centralize infrastructure at a distance from a market jurisdiction, and conduct substantial sales of services from a remote location, combined with the minimal use of physical personnel, allows significant fragmentation in physical operations to avoid taxation.

In this article we have but merely scratched the surface of this highly complex issue. Nevertheless, recent evolutions in the European Union, and to a lesser extent in the USA, illustrate that the online dimension of the gambling & lotteries market continues to grow in importance. Notably the Commission Recommendation on consumer protection in online gambling shows that, in the EU, regulation and possibly even harmonization is around the corner. Properly addressing BEPS in the EU regulatory environment of online gambling could help to tackle cross border gambling services offered illegally from Malta, Gibraltar, Alderney or even Antigua & Barbuda into other jurisdictions. ■

1 The definitions and context in relation to BEPS are taken direction from the action plan itself. It is available at: http://www.oecd.org/ctp/BEPSActionPlan.pdf

2 http://www.oecd-ilibrary.org/docserver/download/2314251e.pdf?expires=1412586133&id=id&accname=guest&checksum=AEB47973329E5808355A696C974B269C

3 P. 14.