

Your World First

C/M/S/

Law.Tax

# Taxation of the digital economy

March 2019

# Contents

- 3  Does the Digitalised Economy Require a Tax Evolution or a Tax Revolution?
- 7  E-commerce: the EU Revises the VAT System
- 10  Digital Permanent Establishment
- 14  Initial Coin Offerings – a New Source of Financing
- 20  Taxation of the Digital Economy – Service Platforms
- 24  Contacts
- 26  About CMS
- 27  About the CMS Tax Practice
- 28  Where You Can Find CMS

**Bloomberg**  
**BNA**

Compilation of articles written by CMS and published in Bloomberg BNA during the course of the year 2018.  
Reproduced with permission from Copyright 2019  
The Bureau of National Affairs, Inc. 800-372-1033 [www.bna.com](http://www.bna.com)

# Does the Digitalised Economy Require a Tax Evolution or a Tax Revolution?

Stefano Giuliano, Partner

This publication aims to identify various aspects of the digital economy and to consider whether income taxes are the most effective and efficient way to tax this economy. Do we need a revolution in the tax system?

It is always challenging to write about something knowing that there are more questions than answers. With the comfort of being just some of the many facing the same problem, in this first of a series of articles we will provide a general overview on the status of the debate about taxing the digitalised economy. In the next parts of the series we will dive into some of the tax implications of technologies that are at the forefront of the digitalisation process.

## What has Happened so Far?

In the last few years there has probably been more discussion around the taxation of the digital economy than any other tax matter. Yet, notwithstanding the amount and depth of discussion, we are still facing a situation where there is no consensus on how it would be fair to approach the digital economy from a tax standpoint.

As part of the work carried out on the Base Erosion and Profit Shifting (BEPS) Project (in particular in the 2015 Action 1 Report), the Organisation for Economic Co-operation and Development (OECD) has recognised that digitalisation, and some of the business models that it facilitates, present important challenges for international taxation and that some of these challenges, mainly nexus, data and characterisation, are of a very broad nature.

At the same time, an important conclusion reached by Action 1 is that digital, or digitalisation, is not something that should be ringfenced, but rather is a transformation that is affecting all business sectors. In the journey towards the identification of a fair tax system for the future, this should shift the focus from “the digital companies” to “the digitalisation of the economy.” It is a matter of fact that, in discussions about these issues, and not only at OECD level, reference has increasingly been made to the latter and not to the former and, if there is any truth in the Latin saying *nomina sunt consequentia rerum* (“names are the consequence of things”), there must be a reason for that.

A further confirmation that this should be the right approach comes from the way “digital” is looked at in non-tax discussions. When recently asked, “What do we mean by “the digital economy?” Vitor Gaspar said “The answer is – as the XXI century unfolds – the economy itself.”

Going back to the Action 1 Report, the OECD analysed three options to tackle the challenges raised by digitalisation:

- a new nexus rule in the form of a “significant economic presence” test;
- a withholding tax which could be applied to certain types of digital transactions; and

- an equalisation levy, intended to address a disparity in tax treatment between foreign and domestic businesses where the foreign business had a sufficient economic presence in the jurisdiction.

Ultimately, none of these options were recommended; however, it was concluded that, as additional safeguards against BEPS, countries could introduce any of these options either in their domestic laws (provided they respect existing treaty obligations), or in their bilateral tax treaties. Such conclusion was reached also under the assumption that the measures developed in the BEPS Project would mitigate some aspects of the broader tax challenges and that the implementation of the measures to address the value-added tax/goods and services tax (VAT/GST) challenges (particularly the International VAT/GST Guidelines), would lead to a more effective and efficient collection of these taxes in the market jurisdiction.

### Lack of Consensus?

Fast forward to the month of March 2018, and the OECD has issued its Interim Report on the challenges arising from digitalisation. The Report reflects the work done by the Task Force on the Digital Economy and, overall, the progress made by the Inclusive Framework since the 2015 Action 1 Report.

Not surprisingly, there is little or no doubt on the need to continue to monitor how the digital transformation might impact value creation. However, there is a high level of uncertainty around the impact that data and user participation have on the creation of value. This has resulted in a lack of consensus on the need to change the existing tax rules as a consequence of the features that seem to be common to certain highly digitalised businesses.

The prevailing current of thought inside the Inclusive Framework can be described as follows:

- a first group that does not see the case for wide-ranging change. These countries consider that the potential misalignments between value creation and taxing rights driven by “data and user participation” should be confined to certain business models and, therefore, should not undermine the principles of the existing international tax framework;
- a second group that believes that the new challenges being faced are not exclusive or specific to highly digitalised business models. According to these countries, the digital transformation, as well as globalisation of the economy, present challenges to the continued effectiveness of the existing international tax framework;

- a third group that does not currently see the need for any significant reform of the international tax rules. These countries believe that the BEPS package has largely addressed the concerns of double non-taxation, although these countries also highlight that it is still too early to fully assess the impact of all the BEPS measures.

Given the different views inside the Inclusive Framework, the conclusion reached has been to work towards a consensus-based solution on the rules on allocation of profits to the different activities carried out by multinational enterprises and on the rules on allocation of taxing rights between jurisdictions.

No consensus has been reached also with respect to the need for interim measures. On one side, a number of countries consider that an interim measure will give rise to risks and adverse consequences, irrespective of any limits on the design of such a measure. On the other, there are countries that, due to the lack of consensus on a global solution, are in favour of the introduction of interim measures, and believe that the possible adverse effects of such measures could be mitigated.

### EU Digital Tax Package

While the OECD was announcing the need for further work before reaching a conclusion, the European Union (EU) issued a “digital tax package” that includes proposed legislation, with the goal of reforming existing rules to tax the digital economy in a fair, growth-friendly and sustainable way; and, at the same time, proposed interim measures to generate immediate tax revenues.

In this sort of race to find a solution to the challenges posed by the digitalisation of the economy, the EU thought that being a first adopter would put it at the forefront in shaping the global response.

The long-term solution proposed by the EU is to tax companies in each EU member state where they have a significant digital presence. According to the proposal, companies would become taxable if they reach one of the following thresholds:

- revenue from supplying digital services exceeding EUR 7m;
- number of users exceeding 100,000 in a taxable year; or
- number of online business contracts exceeding 3,000.

As a short-term fix, the EU is proposing the introduction of an interim tax of 3% on revenues generated by companies with annual revenue of more than EUR 50m in the EU and more than EUR 750m worldwide. The tax would be applied to revenues arising from three main types of services, where the main value is created through user participation:

- online placement of advertising;
- sale of collected user data;
- digital platforms that facilitate interactions between users.

It seems that the key characteristics of the digital economy that are behind the EU proposed legislation are that digital companies are growing fast, rely less on physical presence and pay lower tax rates.

In addition, the EU looks at the existing rules as old and designed for “brick-and-mortar” businesses; and therefore inadequate to effectively tax profits generated by the digital economy.

## Unilateral Initiatives

In the middle of all of this, governments are proceeding with uncoordinated unilateral initiatives. At a high level, these initiatives generally fall into one of the following categories:

- **alternative applications of the permanent establishment (PE) threshold:** some countries have “adjusted” the PE definition under their domestic legislation and/or treaty provisions. Generally this is done by relying on indicators of “digital presence” to establish taxing rights;
- **withholding taxes:** this is generally done by broadening the categories of exception to the PE rule under which the taxing right is allocated to the source country to include categories that target digital products and/or services;
- **turnover taxes:** a large number of countries have adopted non-income tax measures in the attempt to subject to tax foreign-based suppliers of digital products and/or services;
- **specific regimes targeting large multinational enterprises:** some of the base erosion actions undertaken by many countries were prompted by – and will likely have an impact on – those activities as well, even if not specifically introduced to target highly digitalised activities.

## Where Are We and What Should We Expect to Happen Now?

Although the EU has been working closely with the OECD, there seem to be differences between the ways they look at the issue.

It might just be semantics but the EU tends to refer more to “digital companies,” while the OECD is of the view that the “digital economy” is the economy itself.

It is a fact that “digital” is growing fast and does not need big plant or bulky machines to carry on business, but “digital” is not just “digital companies.” At the same

time, the figures show that there are companies that pay low, or lower, taxes, but they are not exclusively those identified as “digital.”

In an environment where “street debate” is, at times, driving political actions, or reactions, roles and responsibilities should not be confused. Companies do not decide tax policies or tax rates, governments do. Companies choose where to go and, if there are countries that have set low corporate tax rates, should entrepreneurs be prevented from establishing their businesses, or companies from moving their operations, there? Make no mistake, we are not talking about “artificial” structures (those deserve a different discussion and should be the target of a different type of rules) but real business. We cannot forget, however, that in today’s world real business is more and more likely to be something that relies less on physical presence, and grows rapidly.

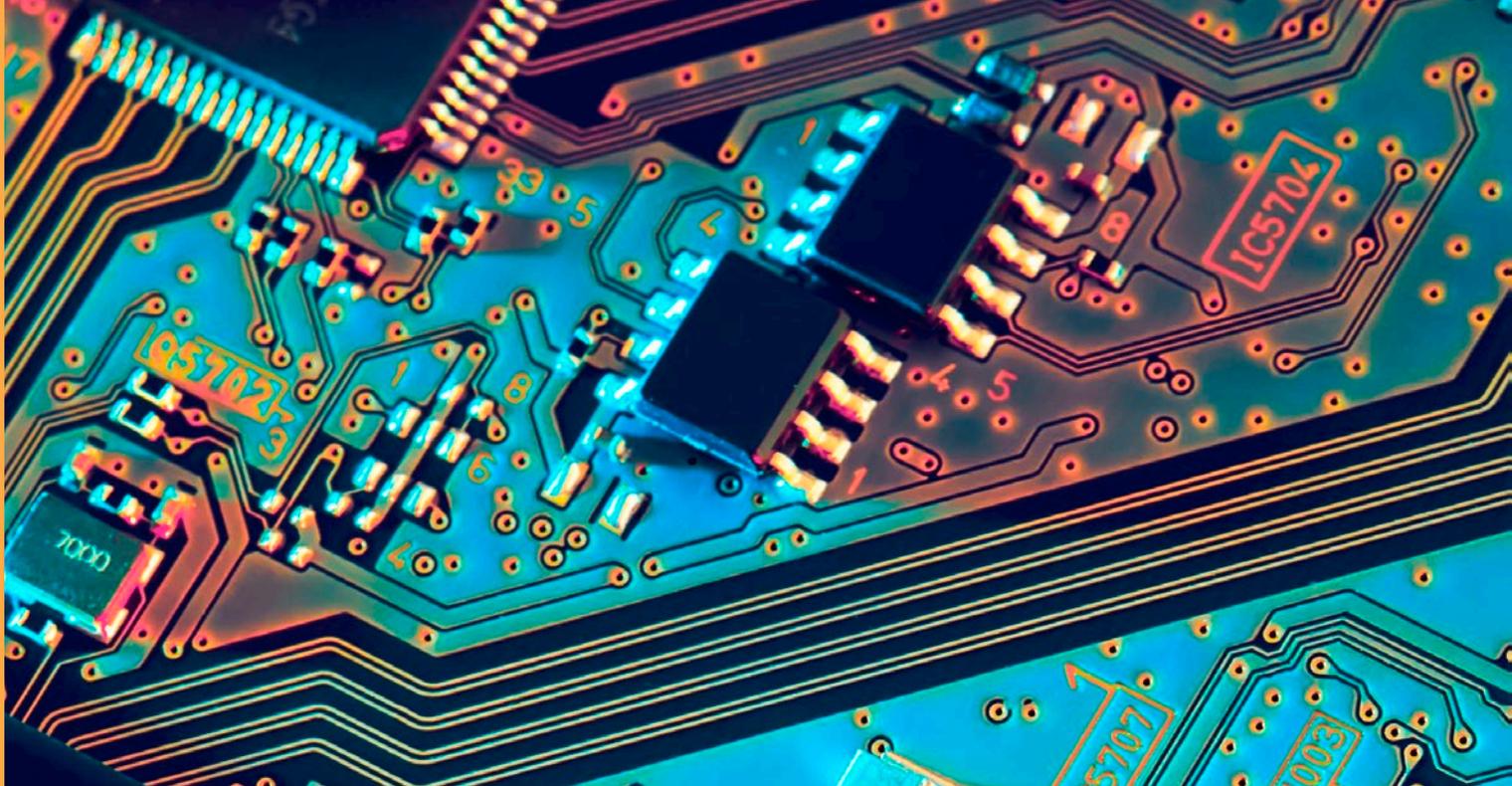
Although very sensible, the decision of the OECD to take more time for the identification of a solution (the proposed deadline is 2020) is not working in favour of a quick, consensus-based, answer that would be beneficial for businesses, governments and consumers.

On the other hand, the EU move might create a number of issues that would be difficult to deal with. The lack of coordination of the proposed actions (interim and long-term) with the existing treaty network is likely to generate double taxation, and we know that double taxation is as bad as double non-taxation. There is a significant risk that the burden (all or part of it) generated by the interim solution might be shifted to consumers. Last but not least, interim solutions have often become permanent.

Uncoordinated initiatives would inevitably contribute to the creation of tax arbitrage and disparity, not only between companies, but also between consumers located in different parts of the world.

What seems to be happening is that the traditional tax framework is being shaken and the current way of thinking about tax is coming under a lot of pressure. With the pace at which the economy is reinventing itself accelerating ever more rapidly, corporate income taxes might be playing a catch-up game that they will never win. The result could be that at some point corporate income taxes (as we think of them today) would become residual and new forms of tax will be introduced.

The concept of residency, with the PE rules working as a sort of “modified residency”, has been the pillar of corporate income tax systems to establish taxing rights. This worked almost flawlessly in an environment where there was a substantial overlap between residency (primary or modified), functions and risks. In that



environment, it was generally accepted and fair to allocate profits to the jurisdiction where functions were performed and risks were borne.

The digitalisation of the economy seems to force reflection on the need to shift part of the value to where the customers/users are, irrespective of whether that is the place where functions/risks are.

One way of looking at it could be to challenge the concept of residency as the pillar of corporate income tax systems. Depending upon the solution adopted, however, this could lead to a different discussion: would the “to-be” tax still be an income tax? Would shifting value away from where functions and risks are change the nature of the tax?

If we wanted to be more aggressive, we should probably ask ourselves if corporate income taxes still make sense in a digitalised global economy? Not only whether they are technically the right answer, but, arguably more important, are income taxes the most effective and efficient way to tax the new “digitalised economy”?

This is not just a discussion about the use of data collected through social networks. There are endless types of “exchanges” that are being executed every second. Just to mention an example that usually would not capture the attention: car and aircraft engine manufacturers are today collecting data real time to improve the performance of existing products, fix problems or develop new products. Irrespective of where the legal entities collecting and/or using the data are, the data providers and the service recipients move around, sometimes to different countries, while

data are being exchanged and services being rendered. Is the users’ participation (and its value creation) in these transactions different from that happening through social networks? Should this type of “exchange” be treated differently? Where are those legal entities carrying out their R&D work? Where are services being rendered? Where should they pay income taxes? Is an income tax the best form of tax for these types of transactions?

## Going Forward

Some of the above might sound provocative but allow us to close this introduction with a further “unconventional” thought.

No matter how we look at this, reaching consensus on a long-term solution seems difficult; and, no matter how smart and talented the people working at this, the legacy of “traditional” income tax concepts seems to inevitably complicate the identification of a fair, neutral, effective, efficient and sustainable solution.

An interesting experiment would be to create a think tank made of young individuals with no legacy of everything that has been written and said on residency, permanent establishment, double taxation or double non-taxation, and see what they would come up with if they were asked to design a system to collect the money to run a country in a highly digitalised economy... or more correctly, in today’s world.

# E-commerce: the EU Revises the VAT System

*Elisabeth Ashworth, Partner, CMS France*  
*Marie-Odile Duparc, Counsel, CMS France*  
*Amélie Retureau, Counsel, CMS France*

The European Union is introducing a major overhaul of the VAT system in relation to the intra-Community supply of goods. Its objectives are ambitious, and some aspects may still require clarification.

On 5 December 2017 the European Union (EU) adopted a directive that, effective 1 January 2021, will adapt the VAT system to the growth of e-commerce.

A first step was taken for electronic services (as well as telecommunications, radio broadcasting and television, also called "TBE Services"), which, since 2015, have been taxed for non-taxable persons (mainly all private customers and non-taxable public bodies) in the country of consumption, at that country's VAT rate. The providers concerned, whether established in the EU or not, were the first to be able to use a mini-one-stop-shop (MOSS) to declare and pay to an EU Member State the VAT due in each country of consumption. The member states then split the revenues among themselves using an information and compensation system managed by the European Commission. The MOSS frees the companies from having to VAT register and declare the tax in each member state where their customers reside.

For the sale of goods, the VAT system is still focused on the "B2C" consumer model for most national sales. The current VAT rules are especially favourable to fraud and unfair competition, which are made easier by e-commerce in a global context.

The new rules generalise taxation at the place of consumption by non-taxable persons and, are designed

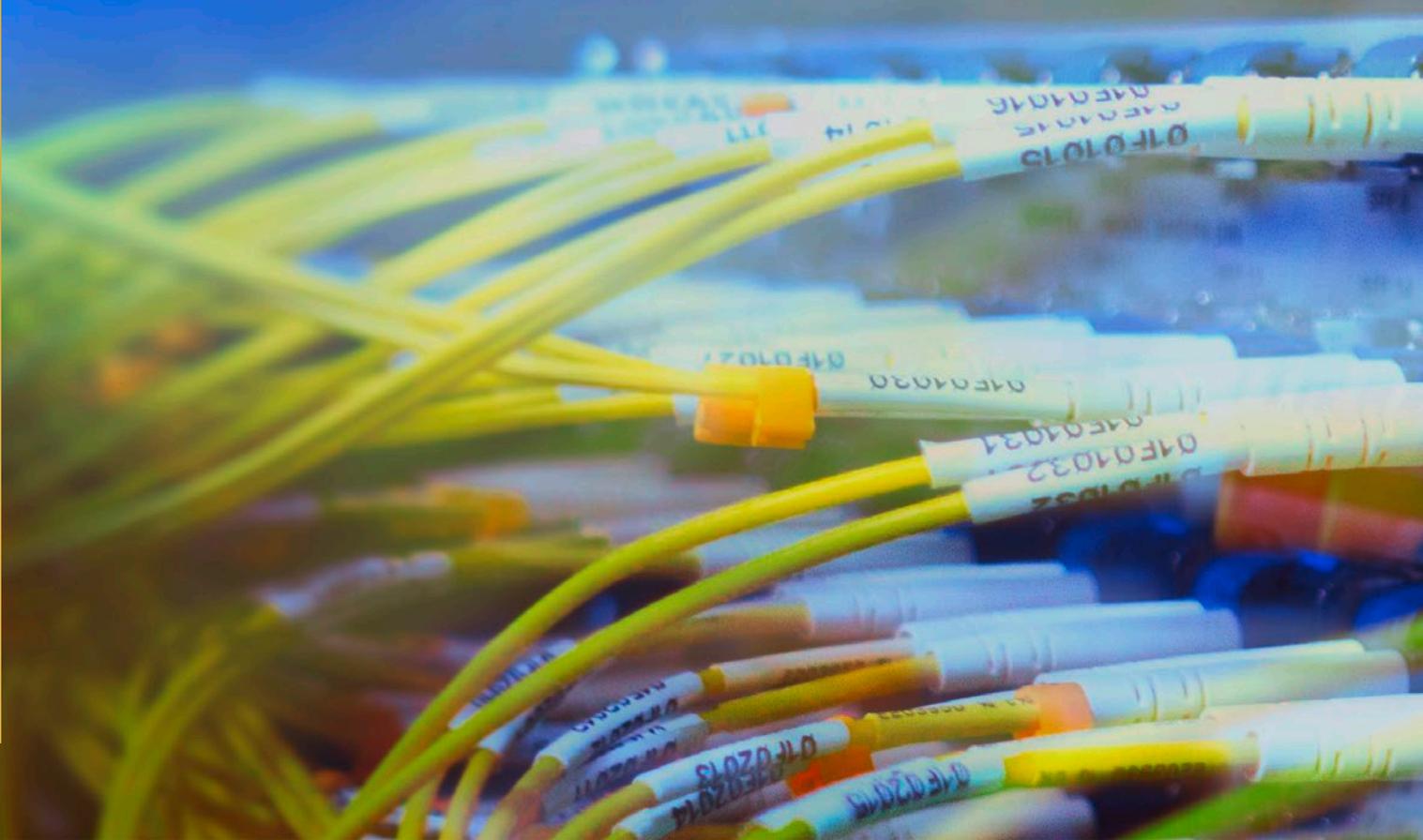
to consolidate EU member states' collection of the tax related to such "B2C" sales of goods and services while making procedures easier for companies.

## A Distance-sales Tax Scheme Better Adapted to E-commerce

For intra-EU trade, the rule is already that sales are taxed in and at the rate of the country in which the customer is established, but there are thresholds, determined by the destination member state, below which smaller companies may, for simplification purposes, apply the VAT of the state from which the goods are shipped to the customers. This system distorts competition and even leads to fraud, in particular for sales made through marketplace platforms, where the sellers offering the best prices are often selling from a member state that applies the lowest VAT rate to the product sold.

In the new scheme, only European companies that are starting up their business will be able to tax the sale in the member state of departure, because this special scheme will apply only if turnover (from goods and services added together) does not exceed EUR 10,000 per year across the EU.

From 1 January 2021 and for all other operators, taxation at the place of consumption will be the rule.



## Sales of Goods from Outside the EU

For sales of goods from states or territories outside the EU, the VAT rules will change significantly. The new directive removes the EUR 22 threshold below which consignments of negligible value were, until now, eligible for a VAT exemption on importation. This exemption, which operators had only to claim on their import declaration, made efficient customs inspection when parcels enter EU territory even more of a pipe dream, given the substantial and constantly increasing number of parcels sent to private customers. All distance sales of goods from third countries to private customers must now be subject to VAT.

## Low-Value Consignments

However, for consignments of low value (i.e., the intrinsic value of which does not exceed EUR 150), VAT will be paid in one of the three ways specifically created by the new directive.

- first, if an e-commerce platform facilitates the sale, this platform will be responsible for paying the VAT because it will be deemed to have purchased and then sold the goods in question;
- if no platform was involved, importation, which in theory gives rise to payment of VAT, may be exempt (“special scheme for distance sales of imported goods”). Distance sales of imported goods will therefore be taxed directly in the customer’s member state if the seller elects to declare and

pay VAT via a new one-stop-shop: the import one-stop-shop, or “IOSS”. To access this portal, the seller must be established in the EU or in a country with which there is a mutual legal assistance agreement equivalent to the agreement between the EU member states, or the non-EU seller must appoint an intermediary that satisfies such a condition;

- if the seller does not elect or is not entitled to use the IOSS, the import may be subject to VAT paid by the customer. According to this special import arrangement, the postal service or express courier responsible for the delivery will obtain payment of the VAT to pay it over to the tax authorities. Our understanding, however, is that this scheme will not apply unless the member state of import is also the member state where the beneficiary of the sale is established (MS of consumption).

Moreover, platforms will also be designated as liable for payment of the VAT on all deliveries of goods within the EU made by non-EU sellers when the platforms facilitate such sales.

## Extension of the One-Stop-Shop

All operators, whether or not they are established in the EU, will be able to opt to use the OSS system that was tested for TBE services for all services sold to private customers that are taxable at the place of consumption. Declarations through this portal must be made on a quarterly basis.



The same OSS system will also be available for Intra-Community distance sales.

In addition, the equivalent but separate one-stop-shop (IOSS) may be used by companies, whether established in the EU or not, that conduct distance sales of imported goods, provided they satisfy the conditions (see above). Declarations through the IOSS must be made monthly.

Note that the one-stop-shops do not enable operators to claim their right to deduct the tax on expenses they incur in the member states where they are liable for payment of VAT for sales to private customers, which is regrettable.

Even if they are registered with one or both one-stop-shops, companies (whether established in the EU or not) will still, as is currently the case, have to ask for reimbursement of the input tax using the special procedures set out in Directive 2008/8 (companies established in the EU) or the 13th Directive (companies not established in the EU).

### Application Terms Still to be Specified

Lengthy preparations have already begun so that the EU, member States, tax authorities and companies will be able to apply the new rules on 1 January 2021.

First, several of the new schemes described briefly above will have to be clarified. For example, the consequences of the “purchase-resale” presumption applicable to platforms facilitating distance sales of imported goods

and intra-EU distance sales are far from being clearly defined by the Directive. The same can be said for certain aspects of the special import arrangement.

For the three systems applicable to distance sales of imported goods, the division of liability among the various parties (platform, IOSS intermediary, and postal or express delivery service) needs to be clarified in the case of tax and customs authorities’ audits if, for example, the import exemption based on the intrinsic value of the consignment is challenged.

The concept of intrinsic value must also be clarified regarding both the goods to be taken into account (*a priori* all those contained in the consignment prepared by the seller) and the value to be used, in particular on the fate of import-related costs.

Several issues are also awaiting clarification with respect to the methods for declaring through the OSS and IOSS.

Finally, whilst the OSS infrastructure has already proven itself for the MOSS for electronic-services providers, its extension will require significant work to adapt the system, and especially to provide for interoperability with the customs databases, because the schemes for imports and sales to private customers will depend on each other.

When the time comes, this new system will still have to prove itself with respect to the ambitious objectives assigned to it.

# Digital Permanent Establishment

*Annabelle Bailleul-Mirabaud, Partner, CMS France*

*Céline Pasquier, Associate, CMS France*

The traditional concept of “permanent establishment” was born in the era of brick and mortar companies and relied on their physical presence in a given state to trigger the taxation of their activities performed there.

As pointed out by the Organisation for Economic Co-operation and Development (OECD) (**OECD report “Addressing Base Erosion and Profit Shifting”** published 12 February 2013), the digitalisation of the economy puts pressure on this concept, as non-resident taxpayers can derive substantial profits from transactions with customers located in another country without having a substantial physical presence or a dependent agent in such country – thus without having a taxable presence there. In addition, the digitalised economy relies to a certain extent on users to contribute to value creation, and also relies heavily on intangible assets and on data collection, processing and use.

## Initiatives to Address Digital Permanent Establishment

As a result, initiatives emerged at both domestic and multilateral (OECD and European Union, “EU”) levels to capture the digital economy business models through the broadening of the traditional permanent establishment (PE) concept, resulting in the emerging concept of “virtual PE,” or “digital PE.”

### Country Level Initiatives

Some countries unilaterally implemented legislation addressing the concept of digital PE. The most advanced countries are Israel, India and the Slovak Republic.

Israel is a way ahead of India and the Slovak Republic, as it introduced a circular in 2016 on “significant

economic presence” which is in force and applies to digital products and services. Building on the same concept, India introduced the “significant economic presence” in its law. This should become applicable as from 1 April 2019.

In the Slovak Republic, an expanded definition of the fixed place of business was introduced to address facilitation of conclusion of contracts through an online platform (for services of transportation and accommodation).

Other initiatives were adopted in various countries consisting in either a diverted profit tax (UK, Australia) or equalisation taxes (India and Italy).

Considering that all these initiatives are domestic, they should only apply with non-tax treaty jurisdictions. For this reason, a multilateral solution is being looked for: the digital PE concept is under discussion and is a work in progress for both the OECD and EU.

### OECD: Where Does it Stand?

The OECD dedicated the first action of its anti-Base Erosion and Profit Shifting (BEPS) Action Plan to the tax challenges arising from digitalisation. In its **Final Report** dated 5 October 2015, the OECD identified several routes to address the taxation issues raised by the digital economy business models, including a new “nexus” definition relying on significant economic presence.

However, no recommendation was issued in this respect.

Building on its 2015 Final Report, the OECD released its **Interim Report on Action 1** on 16 March 2018. The Interim Report points out that (other) OECD BEPS Actions have led enterprises to modify their business structures “to improve alignment with their real economic activity.”

However, the BEPS package may not be sufficient, and the international tax system will need to be further adapted. The Interim Report analyses the coverage of the BEPS package, the digital business models implemented, and contemplates a better understanding of the value contribution of certain aspects of digitalisation.

The OECD would carry out further work on the amendment of the “nexus” criteria for the characterisation of a PE and on profit allocation rules applicable to the digital economy, in order to recommend a long-term multilateral solution.

A new Report should be released in 2020 and a first update should be provided in 2019. On 16 March 2018, more than 110 countries confirmed their support for this initiative in the context of the Inclusive Framework on BEPS. The aim is to build a consensus-based solution.

## Tax Challenges Indirectly Addressed Through BEPS Actions

To date, the tax challenges raised by the digitalisation of the economy have indirectly been partly addressed by the OECD through other Actions of the BEPS package in relation to transfer pricing and to the broadening of the general PE definition (i.e., not specifically focused on the digital economy, but with an effect on it).

On the transfer pricing side, reference to the “development, enhancement, maintenance, protection or exploitation” (DEMPE) of intangibles has been included in the OECD **Transfer Pricing Guidelines** for Multinational Enterprises and Tax Administrations (OECD Transfer Pricing Guidelines) in order to determine which entity is entitled to the profit derived from intangible ownership (Actions 8 to 10 on Aligning Transfer Pricing Outcome with Value Creation and Action 13 on Transfer Pricing Documentation).

On the PE side, the OECD **Final Report on Action 7** “Preventing the Artificial Avoidance of Permanent Establishment Status” dated 5 October 2015, recommended amendments to the PE definition in double tax conventions which are intended to be implemented further to the signature of the **Multilateral Convention** to Implement Tax Treaty Related Measures to Prevent BEPS (the MLI) on 6 July 2017.

Amendments to the traditional PE definition notably include the introduction of an anti-fragmentation rule to allow characterising a PE in case of exercise of several

preparatory and auxiliary activities (which on a single basis do not allow characterising a PE) that are part of a cohesive business operation in a same country.

As a result, in the context of the digital economy, this means that where an online platform has warehousing delivery, merchandising and information collection activities allocated among two sites in a same country, it would have a PE where the warehouse and office business activities of the company would constitute complementary functions that are part of a cohesive business operation.

In addition, in order to address the artificial avoidance of PE status through commissionaire arrangements, the dependent agent PE notion is broadened so that a PE shall be characterised not only in case of conclusion of contracts in the name of a foreign enterprises, but in all cases where:

*“[a] person habitually concludes, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise and these contracts are in the name of the enterprise, or for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or for the provision of services by that enterprise [...]”.*

This may enable the tax authorities to tackle, for example, online advertising pre-sales structures where such structure would habitually play the principal role leading to the routine conclusion of sales by the foreign company to customers in the other country without material modification of the terms and conditions on which the customers offer to purchase the advertising space (**OECD Additional Guidance** on the Attribution of Profits to a Permanent Establishment dated 22 March 2018).

The signature of the MLI is to lead to the implementation of PE amended clauses in all covered tax treaties, but it is subject to reservations made by countries, notably on the implementation of PE clauses. For instance, Ireland and Luxembourg reserved the right not to apply the entirety of the commissionaire and anti-fragmentation clauses in their covered tax treaties.

Still, the MLI PE amended rule may be implemented at a later stage in the context of the renegotiation of an existing tax treaty. While Luxembourg had reserved its application of the commissionaire amended clause and the anti-fragmentation rule, the double tax treaty renegotiated between France and Luxembourg has overcome this restriction and the two rules have now been introduced in the revised double tax treaty signed by France and Luxembourg on 20 March 2018.

In parallel to the negotiation of the MLI and potential reservations that could be made by the various states on the implementation of PE clauses which could have an impact on the digital economy, the OECD pursued its study of the digital economy and of the digital PE. As mentioned above, this should lead to new recommendations from the OECD by 2020.

Reinforced by the work of the OECD, but with the willingness to move at a quicker pace, the EU is now one step ahead.

The new concept of virtual, or digital, permanent establishment and its tax treatment is creating a challenge on a global scale. The European Union (EU) has been particularly active in recent years in relation to tax treatment of the digital economy.

## Two Proposed Directives

On 21 March 2018, two proposals for directives were published. The first proposal on the Digital Services Tax would introduce a 3% tax based on revenues which applies to digital service providers with annual worldwide revenues which exceed EUR 750m (approx. USD 882.4m) and annual taxable revenues in the EU which exceed EUR 50m. This is designed as an interim measure to be implemented until the second comprehensive measure on significant digital presence (Proposal for a directive laying down rules relating to the corporate taxation of a significant digital presence, COM(2018) 147 final, 21 March 2018 (the Proposal) is itself implemented.

Only the long-term measure presented under the Proposal addresses digital PE.

## Significant Digital Presence

Under the significant digital presence approach of the Proposal, a new taxable nexus would be introduced to address the situation of “digital businesses operating across border in case of a non-physical commercial presence” (Proposal COM(2018) 147 final, page 2). Pursuant to the Proposal, a digital PE would be characterised where a “significant digital presence” exists through which a business is wholly or partly carried on.

A significant digital presence shall be characterised in an EU member state by a business consisting wholly or partly of the supply of digital services through a digital interface, provided that one or more of the following conditions is met during a fiscal year:

- the proportion of total revenues obtained and resulting from the supply of those digital services to users located in that member state in that tax period exceeds EUR 7m;

- the number of users of one or more of those digital services who are located in that member state exceeds 100,000;
- the number of business contracts for the supply of any such digital service that are concluded by users located in that member state exceeds 3,000.

These thresholds aim at targeting large enterprises. “Digital services” refer to any “services which are delivered over the internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology” (Proposal COM(2018) 147 final, Article 4).

The figures provided are construed as reflecting the aggregate business generated by the supply of those services through a digital interface by the entity carrying on that business and any of its associated entities.

For greater clarity, the proposal further lists a number of services within or outside the scope of digital services. Services outside the scope include radio and video broadcasting, telecommunication services, access to the internet, telephone services through the internet, etc.

The Proposal applies to enterprises irrespective of their place of residence. Among member states, the digital PE concept would be directly applicable. In their relations with third countries, however, member states would have to amend their tax treaties to introduce this concept, which is strongly recommended by the European Commission (Commission recommendation relating to the corporate taxation of a significant digital presence, C(2018) 1650 final, 21 March 2018), as it would ensure a level playing field within the EU between member state enterprises and third country enterprises, in the interest of member state enterprises.

The concept of significant digital presence would not modify the existing criteria of the PE but would only supplement them.

Further to introducing this new “significant digital presence” nexus, the Proposal sets up principles for the attribution of profits where a significant digital presence has been characterised. These are in line with OECD attribution of profits to PEs principles, and also take into account the functions performed, assets used and risks assumed, through a digital interface, including DEMPE (development, enhancement, maintenance, protection or exploitation) functions. (Proposal COM(2018) 147 final, Article 5 (Profits attributable to or in respect of a significant digital presence)

The text specifies that (i) activities undertaken by the enterprise through a digital interface related to data or users shall be considered economically significant



activities of the significant digital presence which attribute risks and the economic ownership of assets to such presence, and (ii) such economically significant activities include, inter alia, the following activities:

- the collection, storage, processing, analysis, deployment and sale of user-level data;
- the collection, storage, processing and display of user-generated content;
- the sale of online advertising space;
- the making available of third-party created content on a digital marketplace; and
- the supply of any digital service not listed in points.

The Profit Split Method (PSM) is advocated by the Proposal as the method to be used to split the profit (unless an alternative method is more appropriate).

The Proposal is thus going beyond the Organisation for Economic Co-operation and Development (OECD) base erosion and profit shifting (BEPS).

### Recommended Actions

First, the fact that 100,000 users use a device in the same member state to access the digital interface through which the digital services are supplied would suffice to characterise a significant digital presence (and thus a digital PE) under the Proposal. However, under existing

concepts, it would be necessary to verify whether the new criteria of the dependent agent provided by the revised OECD PE definition would be met).

Further, the PSM is the method favoured to allocate the profits under the Proposal, while, under OECD rules, the PSM method – which is a transfer pricing method – is not recommended to attribute profits to PEs.

### What Next?

The Proposal still needs to be approved by all member states and transposed in their legislation before 31 December 2019; as it relates to direct taxation, the unanimous approval of member states is required to adopt it.

It would then be the first multilateral instrument implemented to address digital PE. The digital PE has not yet come true at the multinational level. And the issue of the profit attributable to the digital PE still remains to be addressed.

# Initial Coin Offerings – a New Source of Financing

*Heino Büsching, Partner, CMS Germany*

*Jörn Heckmann, Counsel, CMS Germany*

*Philipp Koch, Senior Associate, CMS Germany*

ICOs are a new source for raising capital to finance entrepreneurial ventures. They enjoy great popularity, and not only in Europe – although booming markets like China and South Korea have prohibited ICOs to protect investors.

The long-term perspective for ICOs is influenced by how such transactions are treated in terms of tax, because experience has shown that the tax burden to be expected also plays a decisive role when market participants make investments.

## ICO vs IPO

The term “ICO” is based on the term “initial public offering” (IPO). This conceptual approximation is no coincidence, but is supposed to suggest that ICOs can generally be compared to the (state-regulated) issue of shares.

However, this is not the case either in technical or in legal terms, and only to a very limited extent in economic terms.

For instance, in contrast to an IPO, it is not necessarily company shares that are sold in the context of an ICO. Instead, the object of acquisition with regard to an ICO initially is only a digital token (“coin”) that – like the cryptocurrency Bitcoin – can be traded and transferred using the blockchain technology. The company issuing the token is free to determine by technical parametrisation how many tokens are “produced.”

The initial issuing process (“initial coin offering”) generally runs for a predetermined period, which usually commences with the publication of a white paper.

In this document, the issuing company, the venture to be financed and the rights associated with the offered tokens are described. White papers usually also contain further information such as an overview of the founders and an outline of the business plan.

After the expiry of the initial period, tokens can no longer be acquired from the issuing company; their number is definitively fixed.

The initial sale of the tokens is then carried out in a largely automated way by using smart contracts. For this purpose, the investor transfers the desired number of units of a cryptocurrency to the company issuing the token. In return, the investor receives the number of tokens corresponding to the value of the transferred cryptocurrency (via the smart contract).

The company issuing the tokens can then change the collected cryptocurrency into fiat currency (such as Euro) via cryptocurrency exchanges in order to use this money to fund the entrepreneurial venture that is the object of the ICO.

## The Function of the Token

Stocks are a pure financial construct to represent company shares; tokens, however, can have various functions.

Unfortunately, there is no generally recognised classification of ICOs.

The Swiss Financial Market Supervisory Authority uses the following terminology, admitting that there are also hybrid forms:

- payment tokens or currency tokens: they do not give rise to claims on their issuer. They are rather intended to be used, now or in the future, as a means of payment for acquiring goods or services or as a means of money or value transfer;
- utility tokens: they are tokens that are intended to provide access digitally to an application or service, usually by means of a blockchain-based infrastructure;
- investment (or asset) tokens: they represent assets such as a debt or equity claim on the issuer. Asset tokens promise, for example, a share in future company earnings or future capital flows. In terms of their economic function, therefore, these tokens are analogous to equities, bonds or derivatives. Tokens that enable physical assets to be traded on the blockchain also fall into this category.

## Transfer of Tokens

The function of tokens is closely linked to the question of how tokens can be legally transferred. Whereas currency tokens are not associated with further-reaching rights, utility and asset tokens have in common that they represent specific rights. When tokens are transferred, these underlying rights are also to be transferred to the acquirer.

So far, it has rarely been discussed how this happens in legal terms.

In most cases, merely the technical transfer of tokens on the blockchain is considered. It is sometimes stated that this is a purely factual and not a legal transaction. Nevertheless, there must also be a transfer in terms of a legal transaction at least regarding the represented rights.

Taking German law as an example – an act of disposition is required. The easiest way to establish this is by way of assignment pursuant to sections 398 ff. of the **German Civil Code**, if applicable in connection with section 413 of the German Civil Code. In addition to this, there are also other ways of transfer, particularly the transfer of ownership of movable things under property law pursuant to sections 929 ff. of the German Civil Code.

In this respect, utility and asset tokens have no value of their own exceeding the right they represent. In a sense, this even applies to currency tokens although they do not embody a further-reaching right.

In functional terms, all tokens, which are no more than an entry in a decentrally saved database, are similar to an entry in the land register or a sheet in the relevant register relating to a property. They can also be compared to a securitising physical deed in the form of bearer securities.

Bearer securities are so closely linked to the embodied rights that they cannot be transferred separately. Does such a principle of inseparability also apply to tokens – in that the legal transfer of the token alone automatically also establishes the ownership of the represented right?

The practical significance of this question can hardly be overestimated: if tokens can be transferred like movable things, they can, in particular, also be acquired in good faith – at least under German law.

This seems intuitively plausible and corresponds to previous practice: the person who has the public and the private key to the tokens can trigger transactions on the blockchain that are not only irreversible in technical terms but also generally regarded as valid even in the event the disposing party was mentally ill.

This practice also corresponds to the aim of the blockchain technology, which is to facilitate transactions. Thus, it turns out that tokenisation is the ultimate development of traditional securitisation in the form of a physical deed!

Based on this it is also clear that the transfer of tokens on the blockchain from a public key to another public key is not automatically valid. A valid agreement is nevertheless required, and the factual legal situation and the documented legal situation may differ.

The specific structure of a token and the associated legal status of the owner, however, also influence the accounting and tax law assessment – as will be shown below.

## Tokens as Securities under European Capital Markets Law

The question as to how tokens are to be classified under capital markets law is also intensively discussed. If tokens are securities within the meaning of European capital markets law, this would have enormous consequences. In particular, the obligation to publish a prospectus would then generally apply: to date, as far as can be seen, not one prospectus has been published for an ICO.

Without going into detail, it does seem very likely that many of the tokens recently issued are securities.

The decisive formal criterion for the classification as a security is, pursuant to Article 4 (1) No 44 of the EU **Markets in Financial Instruments Directive** (MiFID II), the negotiability on the capital market. This negotiability, however, is exactly what tokenisation on a blockchain is about! And asset tokens are about negotiability on the capital market!

Therefore, it is not a problem in terms of capital markets law that according to one view the necessary negotiability is shown to exist only if the financial product is particularly standardised. It is indeed true that the tokens are designed very differently depending on the issuer. However, there is a misconception here; with regard to standardisation a distinction must again be made between the represented right, on the one hand, and the token as digital bearer security on the other hand. When a traditional right is tokenised, the lack of standardisation is not shown to exist just because other issuers tokenise other rights.

The classification as securities within the meaning of capital markets law further requires that the right can be functionally compared to the statutory standard examples, particularly to shares and debentures. Again, a distinction has to be made between the represented right and the tokenisation. Tokens as such are entirely neutral: they cannot be compared to the category of shares, although this is occasionally misunderstood. If the represented right is comparable to a share or debenture, then the token easily meets the material criterion as well.

Therefore, only two cases are intriguing: first, hybrid tokens with regard to which some elements can be compared to shares or debentures and others cannot. In this regard, it is useful to base the distinction on whether the investment aspect is important enough to justify the applicability of capital markets law. The second case concerns tokens based on which rights which were not marketable before becoming marketable through tokenisation; this is particularly the case with regard to utility tokens. In many cases, the required relation to the capital market will be missing; however, an entirely new form of regulation may be necessary in this respect.

The discussion regarding the types and functions of initial coin offerings has only just begun. This particularly applies to accounting and tax issues. It is therefore basically not possible to make any definite statements.

Nevertheless, in the following sections an attempt will be made to outline the questions in connection with accounting and taxation, based on the initial coin offering (ICO) types mentioned: currency tokens, utility tokens and asset tokens.

### Accounting Aspects Relating to an ICO

The outlined classification is not officially established. It is decisive to focus not on the term or the category of the respective tokens, but on the underlying function and the content. Ultimately, the decisive criterion should be the right the relevant token represents. A first overview will nevertheless be based on the classification outlined above.

Carrying out an ICO raises questions for the issuer and the investor as to the presentation of the relevant transactions in the balance sheet.

### Balance Sheet Implications – Introduction

As a statement of account, the balance sheet provides an overview of the merchant's assets and liabilities at the balance sheet date. In this regard, the liabilities side presents the source of the company's funds based on the equity and debt capital, whereas the assets side shows the use of the funds based on the items of the fixed or current assets. The classification of the individual balance sheet items is subject to the provisions under local accounting rules, in Europe following the accounting Directives of the European Union (EU) (latest **2006/43/EC**; **2013/34/EU**).

Consider the German perspective in the following example of the issues involved. On a corporate level, the accounting treatment may have an impact on corporate tax if the "systems" are connected (like in Germany); particularly in such a case any effects on the profit and loss account may also have effects on corporate tax.

### General Principles

Depending on an asset's intended duration of business use, a distinction is made on the assets side between fixed assets and current assets. The essential characteristic for an item, right or any other legal or actual status to be qualified as an asset is that it can be sold or marketed independently. The assets can be both tangible and intangible; since an ICO is a purely digital transaction, it should be shown as an intangible asset.

Its classification as a fixed or current asset has direct consequences: fixed assets whose use is limited in time must be reduced by depreciation. In the event of presumably permanent impairment, write-downs are to be carried out. Current assets, however, are usually not subject to amortisation. Nevertheless, write-downs must always be carried out in the event of a lower exchange or market price on the balance sheet date. This may be the case particularly regarding means of payment such as tokens.

The classification therefore has considerable practical consequences.

The liabilities of a balance sheet include the equity capital, the debts and the accruals and deferrals. Therefore, depending on the structure of the token, the issuing company may generally record the token as equity or as debt.

The following sections present a first brief overview.

## Currency Token

Currency tokens function as a pure means of payment and do not include any additional rights for the owner, resulting in the fact that such an ICO constitutes only an exchange of means of payment.

## Investor

Acquired currency tokens usually serve the investor's company only for a short time and should therefore in general be qualified as current assets. Since the tokens are a pure cryptocurrency, it appears appropriate to record the tokens under the item "other assets" because such tokens are neither inventories or liabilities nor traditional financial resources.

## Issuer

Capitalising the – usually very low – current expenditures the issuer incurs in connection with the production of the tokens is in terms of commercial law generally possible under the item of intangible assets created by the company itself. Since the tokens are not intended to serve the company permanently due to the planned issue, the expenditures are not to be capitalised but are recorded as reducing the company's earnings.

Transferring the currency tokens in return for another currency then results in extraordinary income for the issuing company in the amount of the investor's consideration. If the investor pays for the currency tokens by means of a cryptocurrency, this amount is (as outlined above) usually to be recorded under the item of other assets in current assets. If the investor uses a conventional currency to pay for the tokens, the amount is traditionally recorded under the liquid funds.

## Utility Token

A utility token grants the acquirer a claim to a one-time future performance (good or service) and consequently includes a specific performance promise. The following outline is based on the assumption that the entitlement to performance included in the utility token is directed

directly against the issuer and is also legally enforceable; it therefore does not include only a non-binding performance promise.

## Investor

The entitlement to goods or services against the issuer included in the utility token appears as the digital equivalent to a voucher or coupon.

Asset items that are a part of the current assets and cannot be classified as any other item must be recorded as other current assets.

Since the utility tokens are usually acquired for the investor's own purposes, no paid down payment is shown to exist. This position only includes down payments that were paid on inventories or on services associated with these and are thus intended for use or for resale. A classification as receivables for deliveries and services should also not fit, since the utility tokens do not establish payment claims to which the investor is entitled for services rendered in the context of the turnover activity under mutual agreements.

Acquired utility tokens should therefore be reported as current assets under the fall-back position of other assets.

In the (extraordinary) event the acquired tokens are intended to serve the investor's company permanently, they should, once again, be recorded only as intangible assets acquired for valuable consideration.

## Issuer

The investor's entitlement to goods or services against the issuer is established by the issue of the utility tokens. If the issuer's performance promise included in the utility tokens is recorded as liability or accrual, the investor's consideration does not initially affect the result.

Any obligations towards third parties that have been certainly, that is legally, established in terms of merit and amount must be recorded as liabilities even though they have not yet fallen due. Liabilities that are uncertain in terms of merit and/or amount are to be classified as accruals, however.

Since both merit and amount of the issuer's obligations resulting from the utility token are already determined when the token is created, they can only be properly classified as liabilities.

In this respect it seems obvious to record such tokens under liabilities for advance payments received. If the company preparing the balance sheet has not yet

rendered the service it owes, a pending transaction is shown to exist; any advance payment already received must then be recorded as liability in order to prevent a non-realised profit to be reported.

## Investment Token

In addition to a pure pecuniary right to repayment of investment, an investment token grants the investor other traditional shareholder rights in the form of voting rights and profit participation.

## Investor

The acquisition of investment tokens resembles the traditional participation in other companies. Typically, these tokens are therefore to be recorded in the balance sheet as financial assets. The term "financial assets" includes investments in other companies; in this regard, a financial commitment to strategic purposes is necessary and the long-term intention going beyond the exclusive achievement of return is required.

A requirement for participation is that, based on a contractual relationship under corporate law, the shares are intended to serve the investor's own business by establishing a permanent connection to those companies (for example by way of linking supply and services or by exchanging personnel). The mere intent to invest capital is, however, not sufficient.

Usually, however, it is not the intention of an entrepreneurial ICO investor to establish a more extensive performance relationship with the issuing company resulting in the fact that the tokens cannot be classified as participation in terms of accounting law.

The balance sheet item of securities to be entered under fixed assets includes fixed-interest securities or securities with profit participation rights. Since securitisation is not required with regard to issued investment tokens and is usually not carried out by issuers, the recording as securities does not appear appropriate.

The position of other assets is intended as a fall-back position for any financial and capital receivables to be classified as fixed assets. Any assets that do not qualify as securities and whose debtors are neither an affiliated company nor have a participating interest in such companies must therefore be recorded under this position.

## Issuer

With regard to the issue of investment tokens the question arises for the issuer as to whether this must be recorded as equity capital or debt capital based on the voting rights assigned in this respect.

Equity capital is available to the company particularly in the form of contributions made by the shareholders (for an indefinite period), whereas debt capital (for example in the form of loans) may come from both third parties and shareholders alike.

The status as equity provider depends on a permanent capital provision, subordination and a full participation in losses; given that an investment token will usually not be associated with the investor's full participation in losses, resulting in the fact that the issuer must record the token as debt capital.

Within the liabilities, it may be required to record the tokens as debt capital items under debentures.

To the extent that debentures are, however, defined as long-term debt capital raised by using organised capital markets in Germany, and other countries, a classification under this position does not appear appropriate. As the blockchain-based issue of tokens is, after all, not issued on organised capital markets, the classification as debentures does not fit either.

Instead, long-term debts that are not raised on the capital market must be recorded under other liabilities. Owing to the lack of other recording options, this therefore also applies to investment tokens issued by the issuer.

## A Short Outline of International Financial Reporting Standards

Financial presentation observing IFRS has so far been discussed with regard to the cryptocurrency Bitcoin. According to this, cryptocurrencies must be recorded under the position of intangible assets pursuant to IAS 38 (International Accounting Standard 38 Intangible Assets).

Depending on the structure of the issued tokens, this classification may apply accordingly to the context of an ICO. It will usually apply to currency tokens based on their mere function as a means of payment. However, if additional rights are assigned via utility or investment tokens, the classification must be based on the international accounting standards in each case.

Based on an initial assessment, the positions of intangible assets (IAS 38), other liabilities (IAS 12) or financial instruments (IFRS 7) can be considered in this regard.

Further discussions and specific statements in this respect can be expected.

## VAT Aspects

With regard to the value-added tax (VAT) treatment of an ICO, the judgment rendered by the Court of Justice of the European Union regarding the **Hedqvist case** on 22 October 2015 is of particular importance. The case deals with the treatment of bitcoins. It is, however, likely that the basic principles can be applied to other virtual currencies.

Basically, an ICO may therefore be a VAT-free sale of tokens. A prerequisite is, however, that the tokens do not serve any purpose other than being used as a means of payment.

Based on the European VAT Directive, it is thus likely that an exemption from VAT may be considered with legal certainty only with regard to currency tokens. It is rather unlikely that this exemption applies to investment tokens because rights exceeding the function of a mere means of payment are transferred to the acquirer.

If the utility token is based on concrete performance promises, the applicability of the VAT exemption is likely to be excluded also in this respect. If no due or specific performance claim relating to a good or service exists, this may be different, however. Further discussion also in this regard remains to be held.

## What's Next?

ICOs are an intriguing new form of financing. As is usually the case with such new forms, a whole range of legal, tax and also accounting questions arise. All these questions will ultimately have to be decided on the basis of common legal instruments. This contribution has thus tried to describe the starting points of the discussion and develop some assumptions. Further discussion is to be eagerly awaited.

# Taxation of the Digital Economy – Service Platforms

Andrzej Pośniak, Partner, CMS Poland

Piotr Nowicki, Senior Associate, CMS Poland

## Sharing Economy and Service Platforms

Sharing economy, “gig” economy, platform economy – these are all terms used to describe the business models of companies like Lyft or Airbnb, whose rapid advancement is disrupting various markets around the globe. In this article we will focus on one particular aspect of the sharing economy i.e. the taxation of service platforms.

Service platforms are businesses in which a facilitator operates a web- or app-based platform, which connects buyers and sellers of certain services. In many cases, payment for the services is also facilitated through the platform.

The main distinguishing criterion of service platforms is the way they create value. Standard business models may be described as “supply chains” or “pipelines” – companies operating this way create value by producing goods or rendering services and selling them to customers. In most cases they adhere to the usual chain of producer, wholesaler, retailer and consumer. Platforms on the other hand create value by bringing together those who demand goods or services with others who have access to surplus resources and may put them on the market. In fact, in many cases the advancement of platforms is what made these surplus resources available in the first place (e.g. Airbnb made it far easier for homeowners to offer accommodation for travelers and as such significantly lowered the market entry barrier).

Moreover, service platforms operate on a particular revenue model that is far less common in the supply chain model than among platforms. The vast majority of platforms earn their profits by way of commission (although different models also exist) with the majority of the revenue being received by the service providers.

This new model of value creation has proven difficult to tax and as a result is a complicated problem for both tax authorities and policymakers. Obviously, legal regulations always lag behind innovative companies, but in case of service platforms this mismatch is particularly visible. Moreover, the difficulty lies not only in taxing the service platforms themselves but also in taxing service providers who use the service platforms to offer their surplus resources to the public.

## Subsidiaries and Permanent Establishments

A general principle of international tax law is that taxation should take place in the state in which value is created. In case of income taxes this principle is realised *inter alia* by way of taxing the local subsidiaries or “permanent establishments” of foreign companies.

The very nature of service platforms allows them to operate in various states without having a physical infrastructure, and in most cases contracts between clients and the service platforms are concluded online. Consequently, service platforms rarely have the need to establish local subsidiaries in order to conduct business in a given state. If service platforms establish local subsidiaries, the actions of those companies are generally limited to marketing and similar services. In compliance with tax regulations, the subsidiaries receive market level remuneration from the parent companies for their services. However, as these services are not the platforms’ main source of value, the remuneration and corresponding tax is limited.

Furthermore, as service platforms have no need for physical infrastructure and they conclude contracts on-line, they are not considered to have “permanent establishments” in the states in which they operate.

In a nutshell, under the current framework of the OECD-based bilateral double tax treaties, a foreign company that does not have a subsidiary in a given state and operates there itself has a “permanent establishment” in that state when its operations have sufficient substance. Currently, a “permanent establishment” is created when a foreign company has sufficient physical infrastructure in a state or a dependent agent, which acts in the name of the company. Due the above reasons, in case of service platforms, these criteria are seldom fulfilled, and service platforms are generally considered to have no permanent establishments in the states in which they operate.

The situation is similar in case of turnover taxes. A good example of this is the EU VAT regulation, which includes the concept of a VAT establishment but at the same time requires this establishment to have *inter alia* a suitable structure in terms of human and technical resources. This also leads to a situation in which under EU VAT law the service platforms are considered to have no VAT establishments in the states in which they operate.

Increasing political and public pressure has resulted in the drafting of regulations aimed at addressing this issue. A good example of this is the proposal for an EU Directive on the corporate taxation of a significant digital presence put forward by the European Commission. These new rules will provide new indicators of economic presence mandating the recognition of a permanent establishment.

Under the new rules a service platform will be deemed to have a taxable “digital presence” or a “virtual permanent establishment” if it fulfils certain criteria e.g. exceeds a threshold of EUR 7m in annual revenues in a state; has more than 100,000 users in a taxable year; or creates over 3,000 business contracts between the company and a business user in a tax year. Such “virtual permanent establishments” will be subject to income tax in the state in which they were created. This will give EU member states the right to tax service platforms on the income received from operating in those states.

Similar regulations are being developed and implemented by other states and organisations. Moreover, it is likely that similar regulations will also be adopted in case of turnover taxes like GST or VAT.

## Withholding Tax

However, the fact that service platforms are not subject to income tax in the states in which they operate does not mean that their services are not subject to tax at all. Because the service platforms have no permanent establishments to which the service payments could be attributed, these payments may be subject to withholding tax.

Many states levy withholding tax on income derived from business operations of foreign companies. Consequently, under domestic tax law the payments made by citizens of these states to service platforms for services (e.g. matching fees or advertising fees) may be subject to withholding tax.

Simultaneously, these payments may be exempt from withholding tax due to the application of international tax law. Under the current framework of the OECD-based bilateral double tax treaties, most of the service payments made by customers and/or services providers will be considered “business profits”. Such profits are subject to taxation in the state from which they are derived only if the receiver has a “permanent establishment” in that state. The result of these regulations is something akin to a “vicious circle” i.e. the service platforms have no permanent establishments in the states in which they operate and therefore withholding tax may apply, but at the same time withholding tax does not apply because the service platforms have no permanent establishments.

However, this would be the case only if the state from which the payment is made does not require that the entity making the payment holds a certificate of tax residence of the receiver. If the opposite is true – and the obtaining of a tax residency certificate is mandatory – then this may mean the customers and/or service providers should account for and pay withholding tax.

The requirement to obtain tax residency certificates may be especially arduous in case of platforms that are mass-market and cover low-value transactions. In such cases it is unlikely that the customers and/or service providers will make the effort of requesting a tax residence certificate from their contractor.

This is not the only practical issue associated with withholding tax. The service platform business model is usually based on commissions. Furthermore, the payments are usually facilitated and controlled by the service platforms. In fact, it’s quite common for a customer to make the payment to the service platform, who after withholding its commission sends the rest of the payment to the service provider. In most jurisdictions the application of this model does not change the fact that from a legal/tax perspective it is the customer/service provider who is making the payment (e.g. deductions and remittances are treated as actual payment) and therefore is obligated to account for and pay withholding tax. Which could be problematic, as such a person may not have access to the necessary data and the payments may be outside of his/her control.

As of now both issues seem to be unresolved and provide a good example of a mismatch between tax regulations and the business environment to which these regulations should apply.

## Data Access and Compliance Among Service Providers

Another aspect of the taxation of service platforms is access to service provider data.

The continuing development of service platforms is causing more and more people to use their spare time or spare resources and become service providers on such platforms. This is particularly true in cases where the advancement of service platforms has lowered entry barriers into certain markets.

Most tax systems apply different taxes to salaried employees and business owners (in most cases business-derived income is taxed separately from salaried income, and owning a business usually entails paying turnover taxes like GST or VAT).

What is more, it is nearly impossible to create a clear definition of what should be considered a “business activity” for tax purposes – due to the very nature of business activity lawmakers must use general terms, which are always subject to interpretation. Under these broad definitions, it is very likely that certain service providers will be considered taxable business owners both in terms of GST/VAT and in terms of income tax. Certain types of activities may also be subject to additional taxes e.g. offering short-term rentals may result in a requirement to account for and pay some kind of tourist tax.

This rather complicated framework of tax regulations and administrative obligations (drafted with traditional businesses in mind) may lead to tax evasion – either voluntary or involuntary (when the taxpayer is not even aware that he should be paying certain taxes).

At the same time, the tax authorities are having serious problems combating this issue – the main problem being the availability of data. Generally, the activities of taxpayers that provide services on service platforms are only visible to clients of those platforms. Consequently, without access to the service platforms’ data, it is very hard for the tax authorities to determine which taxpayers are not in compliance with tax law.

Increasing political and public pressure will most likely lead to the implementation of legislation that will force platform service companies to share the data they have about their users with the tax authorities. However, in this case serious concerns regarding data protection must also be addressed.

Alternatively, a voluntary method of cooperation is also possible – states and service platforms may enter into data-sharing agreements according to which the service platforms will help ensure that service providers comply with the law.

## Conclusions

The development of service platforms and the sharing economy in general, is proving to be a challenge for the current model of tax regulations. It is clear that current tax regulations are a mismatch for these new business models both when it comes to taxing service providers and/or the platforms themselves. The development of digital permanent establishments and the sharing of data between service platforms and the tax authorities is likely to address the most evident mismatches. However, in our view, due to the rapid growth of the sharing economy the current approach to taxation in general will require even more changes. Tax regulations will have to adapt to this new economic landscape e.g. by finding a way to evidence the tax residency of taxpayers without the use of tax residency certificates.



# Contacts

## Does the Digitalised Economy Require a Tax Evolution or a Tax Revolution?



**Stefano Giuliano**

Partner

T +39 06 4781 5305

F +39 06 4782 3139

E stefano.giuliano@cms-aacs.com

---

## E-commerce: the EU Revises the VAT System



**Elisabeth Ashworth**

Partner

T +33 1 4738 5500

F +33 1 4738 5555

E elisabeth.ashworth@cms-fl.com



**Marie-Odile Duparc**

Counsel

T +33 1 4738 4026

F +33 1 4738 4112

E marie-odile.duparc@cms-fl.com



**Amélie Retureau**

Counsel

T +33 1 4738 5500

F +33 1 4738 4226

E amelie.retureau@cms-fl.com

---

## Digital Permanent Establishment



**Annabelle Bailleul-Mirabaud**

Partner

T +33 1 4738 4188

F +33 1 4738 5742

E annabelle-bailleul-mirabaud@cms-fl.com



**Céline Pasquier**

Associate

T +33 1 4738 5521

F +33 1 4738 5742

E celine.pasquier@cms-fl.com

## Initial Coin Offerings – a New Source of Financing

**Heino Büsching**

Partner

**T** +49 40 37630 260**F** +49 40 37630 40536**E** heino.buesching@cms-hs.com**Jörn Heckmann**

Counsel

**T** +49 40 37630 322**F** +49 40 37630 40581**E** jorn.heckmann@cms-hs.com**Philipp Koch**

Senior Associate

**T** +49 40 37630 369**F** +49 40 37630 40733**E** philipp.koch@cms-hs.com

---

## Taxation of the Digital Economy – Service Platforms

**Andrzej Pośniak**

Partner

**T** +48 22 520 5673**F** +48 22 520 5556**E** andrzej.posniak@cms-cmno.com**Piotr Nowicki**

Senior Associate

**T** +48 22 520 8308**E** piotr.nowicki@cms-cmno.com

# About CMS

CMS is an organisation of ten major independent European law firms established in 41 countries. Our offices are mainly in Europe, but also in North Africa, Asia and South America. We are over 4,500 legal professionals based across the world, advising clients on both global and local matters. This enables our lawyers to provide support to the sites operated by CMS, allowing them to respond to clients wishing to incorporate a strong international dimension into their business strategy.

## Our strengths internationally

### CMS is:

- one of the seven most extensive organisations of lawyers in the world.
- a strategic position in Western Europe (Germany, Austria, Belgium, Spain, France, Italy, The Netherlands, Portugal, United Kingdom, Switzerland).
- a renowned presence in Central and Eastern Europe with offices in 13 CEE countries.
- historical connections to North Africa with offices in Algeria and Morocco allowing successful coordination of projects throughout the region.
- ongoing development in South America, Russia, China, Brazil and the Middle East.

**To better understand the various tax, legal and employment needs of our clients, our organisation is structured around 19 practice areas and sector groups.**

### Our lawyers are therefore able to:

- discuss and share their skills and experience.
- refine their overall understanding of their files.
- share their local market strategies.

Practice areas	Sectors of activity
<ul style="list-style-type: none"> <li>— Tax</li> <li>— Banking &amp; Finance</li> <li>— Competition &amp; EU</li> <li>— Corporate/M&amp;A</li> <li>— Commercial</li> <li>— Dispute Resolution</li> <li>— Real Estate &amp; Construction</li> <li>— Intellectual Property</li> <li>— Employment &amp; Pensions</li> <li>— Public Procurement</li> </ul>	<ul style="list-style-type: none"> <li>— Insurance</li> <li>— Consumer Products</li> <li>— Energy</li> <li>— Hotels &amp; Leisure</li> <li>— Infrastructure &amp; Projects</li> <li>— Private Equity</li> <li>— Life Sciences &amp; Healthcare</li> <li>— Technology, Media &amp; Communications</li> <li>— Funds</li> </ul>

# About the CMS Tax Practice

Tax is a key component in the range of services which CMS offers. We have over 400 lawyers (including 120 partners) and tax advisers who offer comprehensive tax planning and advice services across Europe and beyond. In all CMS jurisdictions we offer local expertise as well as international capacity.

## Our approach

Tax is core to our business. Today's organisations have to deal with national and international tax issues on a daily basis, against an increasingly complex legal background. Today, businesses are being built and managed in an environment where tax compliance and tax avoidance are of serious concern with heavy consequences.

What sets us apart is the way we deliver tax services: we offer deep local expertise, allied with industry specialisation, across a network of like-minded advisers who know each other and work together regularly. Our CMS lawyers from across the world meet face to face in tax practice groups, work with each other and really know each other. All this speeds up processes when working across borders.

We also work closely with our colleagues in other disciplines to provide a genuine "one-stop shop".

## Your "one-stop shop"

CMS does not operate through "hubs" or out of "virtual offices". Our tax professionals are local experts working in offices from London to Shanghai, Paris to Casablanca, and Lisbon to Kyiv.

This ensures that clients have access to the hands-on experience and language skills they need, to communicate effectively with the tax authorities, and to resolve tax issues swiftly and efficiently.

## Our tax scope of expertise

CMS tax advisers include tax lawyers, advocates, senior economists and renowned specialists who are "of counsel" – all of whom offer a full range of tax services.

They can advise you on all areas of domestic and international tax, from tax audits and day-to-day compliance to tax planning for the most complex local and international business structures. They advise on all aspects of domestic and international tax law, covering a wide range of sector specialisms. They handle contentious as well as noncontentious matters including advising clients in relation to disputes with the revenue authorities both through the courts and before tax tribunals.

### Representative expertise and experience includes:

- **VAT** (advises on EU-wide developments, domestic VAT disputes in the local courts and before the European Court of Justice, development of VAT planning solutions and structures).
- **M&A** (national and international mergers, acquisitions, joint ventures, privatisations and flotations).
- **Transfer pricing** (full scope of transfer pricing issues, sustained by an integrated economics resource, with a full range of economic analysis from standard searches to complex studies).
- **International taxation** (foreign investments, international property taxation, taxation of the international finance sector, taxation of investment funds and other international investment companies, transfer of tax residency and headquarters abroad, questions regarding principles involved in double taxation treaties, foreign tax law, international litigation, customs duties and forex regulations, ...).
- **Dispute resolution** (high profile litigation before domestic supreme courts, constitutional courts, international courts).
- **Private clients** (representing entrepreneurs, managers, wealthy individuals and their families, as well as banks, asset managers and family-run businesses).

# Where You Can Find CMS

## The Americas

Bogotá  
Lima  
Mexico City  
Rio de Janeiro  
Santiago de Chile



Algiers  
Casablanca  
Luanda

## Africa

## Europe

Aberdeen  
Amsterdam  
Antwerp  
Barcelona  
Belgrade

Berlin  
Bratislava  
Bristol  
Brussels  
Bucharest

Budapest  
Cologne  
Duesseldorf  
Edinburgh  
Frankfurt

Funchal  
Geneva  
Glasgow  
Hamburg  
Kyiv  
Leipzig  
Lisbon  
Ljubljana  
London

Luxembourg  
Lyon  
Madrid  
Manchester  
Milan  
Monaco  
Moscow  
Munich  
Paris

Podgorica  
Poznan  
Prague  
Reading  
Rome  
Sarajevo  
Seville  
Sheffield  
Skopje

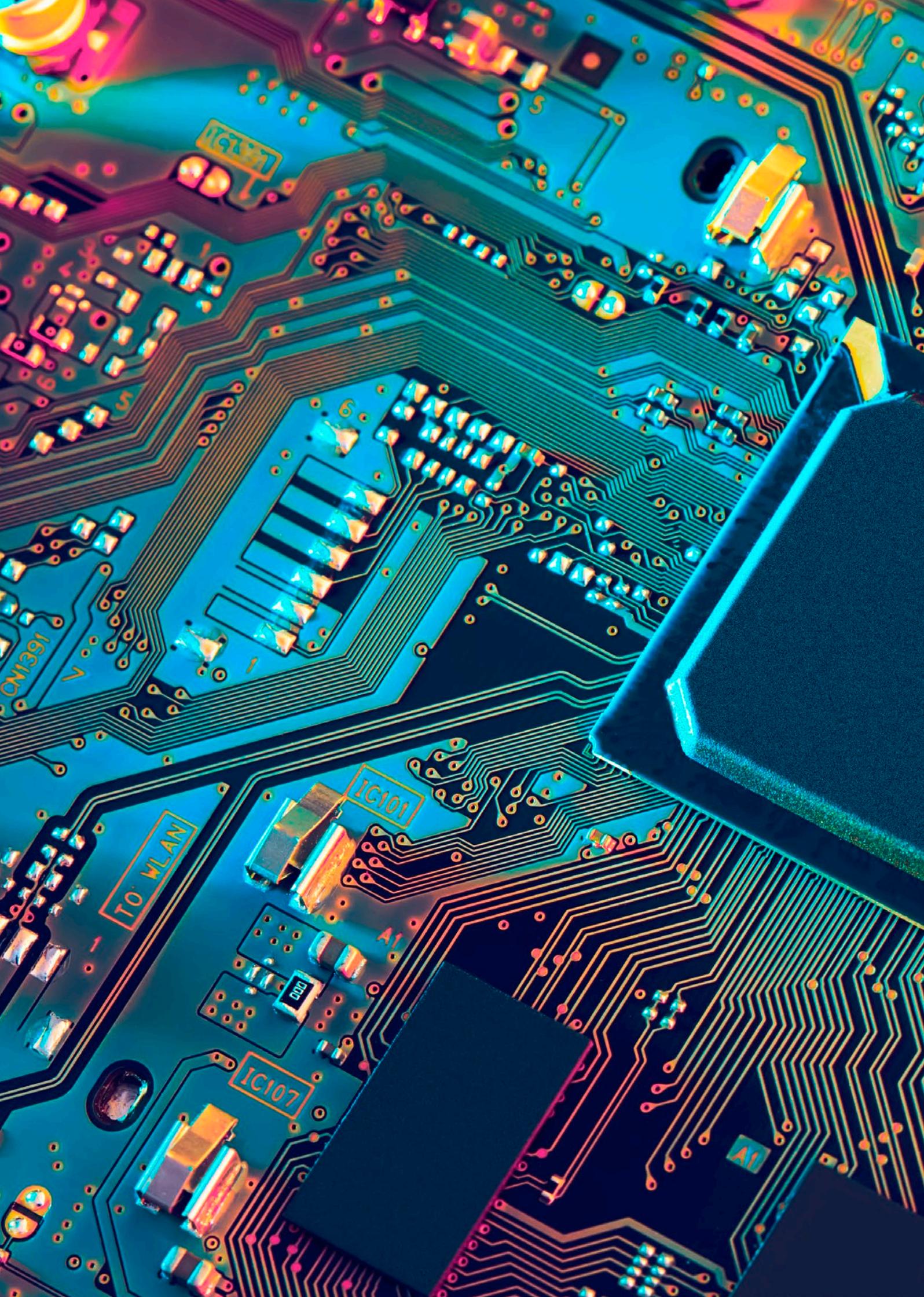
Sofia  
Strasbourg  
Stuttgart  
Tirana  
Utrecht  
Vienna  
Warsaw  
Zagreb  
Zurich

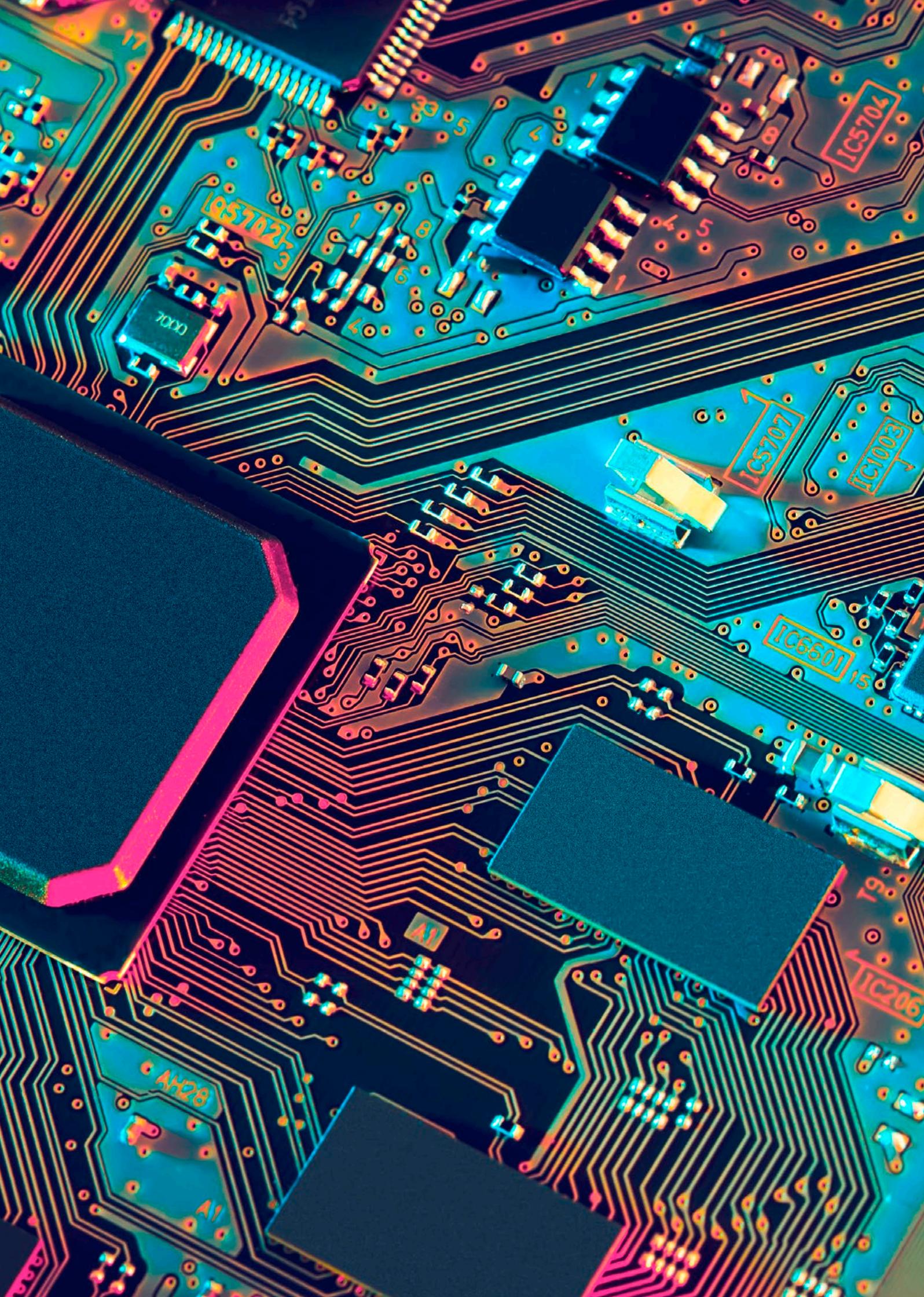
Dubai  
Istanbul  
Muscat  
Riyadh

## Middle East

Beijing  
Hong Kong  
Shanghai  
Singapore

## Asia-Pacific







**Your free online legal information service.**

A subscription service for legal articles on a variety of topics delivered by email.  
**[cms-lawnow.com](http://cms-lawnow.com)**



**Your expert legal publications online.**

In-depth international legal research and insights that can be personalised.  
**[eguides.cmslegal.com](http://eguides.cmslegal.com)**

-----

CMS Legal Services EEIG (CMS EEIG) is a European Economic Interest Grouping that coordinates an organisation of independent law firms. CMS EEIG provides no client services. Such services are solely provided by CMS EEIG's member firms in their respective jurisdictions. CMS EEIG and each of its member firms are separate and legally distinct entities, and no such entity has any authority to bind any other. CMS EEIG and each member firm are liable only for their own acts or omissions and not those of each other. The brand name "CMS" and the term "firm" are used to refer to some or all of the member firms or their offices.

**CMS locations:**

Aberdeen, Algiers, Amsterdam, Antwerp, Barcelona, Beijing, Belgrade, Berlin, Bogotá, Bratislava, Bristol, Brussels, Bucharest, Budapest, Casablanca, Cologne, Dubai, Duesseldorf, Edinburgh, Frankfurt, Funchal, Geneva, Glasgow, Hamburg, Hong Kong, Istanbul, Kyiv, Leipzig, Lima, Lisbon, Ljubljana, London, Luanda, Luxembourg, Lyon, Madrid, Manchester, Mexico City, Milan, Monaco, Moscow, Munich, Muscat, Paris, Podgorica, Poznan, Prague, Reading, Rio de Janeiro, Riyadh, Rome, Santiago de Chile, Sarajevo, Seville, Shanghai, Sheffield, Singapore, Skopje, Sofia, Strasbourg, Stuttgart, Tirana, Utrecht, Vienna, Warsaw, Zagreb and Zurich.

-----

**[cms.law](http://cms.law)**