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Growing Asia's Markets

Digital Services Taxes:
Impact on Financial Services Industry

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A number of countries across the Asia Pacific region are seeking to implement Digital Services Taxes (or similar taxes, as discussed further below) either in lieu of, or in addition to, any new or expanded nexus and profit allocation rules arising from the implementation of Pillar 1 of BEPS 2.0.

For the purposes of this paper, in addition to those measures which are named as such, Digital Services Taxes also refer to:

- any turnover or revenue based taxes applicable to the provision of digital services, or digitalized business activities;
- any expanded applications of corporate income tax withholding provisions to digitalised activities; and
- any measures which seek to tax or expand upon traditional concepts of a permanent establishment so as to create a liability in a jurisdiction in which customers are located.

Excluded, however, are Value Added Tax or Goods and Services Tax (or similar transaction taxes) measures which are also subjects of concern to ASIFMA.

This paper sets out in high level terms the industry's key concerns with the application of any Digital Services Taxes. For the reasons set out further below, ASIFMA members hereby advocate:

- Any forms of Digital Services Taxes should ideally not be imposed. However, should this be necessary then any such measures should be temporary, narrowly scoped and specifically targeted (only) at highly digitalised businesses which are able to deliver new types of business models, services or products with limited (or no) human intervention. The mere enhancement or transformation of existing business models, services or products through greater use of automation is not intended to be within scope of these measures;

- Countries in the Asia Pacific region ensure that any Digital Services Taxes contain an express exclusion for financial services activities, consistent with the exclusion proposed by the OECD under Pillar 1 of BEPS 2.0; and

- The imposition of any temporary Digital Services Taxes should be revoked upon the implementation of Pillar 1 of BEPS 2.0.

1. Core Principles of Sound Tax Policy

The *Ottawa Taxation Framework Conditions*[1], articulated in the context of taxation of electronic commerce, outlines the generally accepted principles of tax policy as being:

1.1 ***Neutrality –*** Taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic commerce.

1.2 ***Efficiency –*** Compliance costs for businesses and administrative costs for tax authorities should be minimised as far as possible.

1.3 ***Certainty and Simplicity –*** Clear and simple to understand so taxpayers can anticipate the tax consequences in advance of a transaction including knowing when, where and how to account for the tax.

[1] confirmed at the Ministerial Conference on Electronic Commerce held in Ottawa on 7-9 October 1998

1.4 ***Effectiveness and Fairness –*** Taxation should produce the right amount of tax at the right time. The potential for tax evasion and avoidance should be minimised while keeping counteracting measures proportionate to the risks involved.

1.5 ***Flexibility –*** *T*he system for taxation should be flexible and dynamic to ensure that it keeps pace with technological and commercial developments.

2. Specific Concerns with Digital Services Taxes

In applying the principles of sound tax policy, ASIFMA members raise the following matters of concern:

2.1 The original intent of Digital Services Taxes was to act as a temporary stop-gap measure, pending the introduction of more permanent solutions, such as Pillar 1 of BEPS 2.0. Digital Services Taxes were ultimately not advocated for by the OECD (refer to the OECD's Interim Report of March 2018), while they were initially promulgated by the EU Commission (though at the end not harmonised). The intended objective of a Digital Services Tax was to ensure an appropriate amount of taxation could be collected on a narrow and very specific range of activities carried out by highly digitalised businesses which are able to access markets without a physical presence in a jurisdiction. By contrast, many types of financial services activities do require a physical presence in the jurisdiction, and in reality, they are being subjected to Digital Services Taxes simply because of potential problems around discriminatory laws in only subjecting non-residents to the tax. What follows from this is that any Digital Services Tax introduced by a country should be narrow, specific, temporary and targeted. The business models used in the financial services sector do not generally accord with the intended target of these measures.

2.2 The OECD proposes that Pillar 1 of BEPS 2.0 contain an express carve out for financial services. The rationale for such a carve out is because the digitisation and automation taking place in the financial services sector primarily acts as a substitute for activities previously carried out manually. Moreover, the extent of automation in the financial services sector is not a complete substitute for human judgment and decision making. To put it another way, the digitisation and automation seen in financial services does not create something entirely new which gives rise to a new taxing right – it merely improves the efficiency of certain tasks previously carried out manually. It is therefore inapt to apply Pillar 1 of BEPS 2.0. It therefore follows that the same rationale should be applied to Digital Services Taxes.

2.3 The other key rationale for the exclusion from Pillar 1 of BEPS 2.0 is because the financial services sector, banking and insurance in particular, is already the subject of significant local regulation in respect of their consumer facing businesses. Such local regulations generally require that appropriately capitalised entities are maintained in each market jurisdiction to carry on business in the market concerned. Accordingly, the profits from consumer facing business activities that arise in a particular market jurisdiction will generally be taxed in that market location. Just as this warrants an exclusion from Pillar 1 of BEPS 2.0, the same is true under Digital Services Taxes.

2.4 Further to point 2.2 above, it is also noted that the UK's Digital Services Tax contains an express exclusion for financial services too. As the HMRC has noted (see DST18700 - Digital Services Tax Manual - HMRC internal manual - GOV.UK (www.gov.uk)):

"There is an exemption from the online marketplace definition for online financial marketplaces. This reflects that financial services businesses have certain features that mean the policy rationale behind DST applies less strongly in their case than it does for other marketplaces.

The exemption is intended to be broad and to encompass all types of financial services activity. It applies when more than half of the marketplace's revenue in the accounting period arises in connection with facilitating the trading of financial instruments, commodities or foreign exchange."

ASIFMA members believe that a similar broad exclusion for financial services should be applied by countries in the Asia Pacific region to their Digital Services Taxes.

2.5 The exclusion of financial services from Pillar 1 of BEPS 2.0 is intended to be focused on a defined concept of financial services activities, recognising that the regulatory environment for financial services differs from one jurisdiction to another, including in respect of key areas like FinTech. The intent of such an exclusion is to ensure consistency in the application of Pillar 1 amongst different countries, and for the scope of any exclusion to apply equally amongst market competitors – for example, a bank carrying out FinTech would be treated on the same footing as a pure FinTech company. Again, we would submit that the same policy rationale applies here to warrant an exclusion from Digital Services Taxes to a broadly defined concept of financial services. Exclusions should also be sufficiently broad to capture intra-group services and transactions, especially intra-group IT and other support services which may be enabled or delivered digitally.

2.6 ASIFMA members have noted a growing and concerning trend of countries in the Asia Pacific region seeking to either implement, or proposing to implement, further alternatives or variations to a Digital Services Tax. Examples include:

- India's equalisation levy;
- Indonesia's 'Electronic transaction tax';
- the deeming of certain digital business activities as constituting a permanent establishment (e.g., Cambodia, Bangladesh);
- the inclusion of digital services provided to consumers in a jurisdiction as being locally sourced income (e.g., Taiwan);
- the expansion of withholding measures to capture digital services (e.g., Vietnam); and
- the concept of a 'significant economic presence' as a basis for the imposition of turnover taxes (e.g., India).

These measures go significantly further than the perceived tax policy problem which needs to be solved. That is, the policy response has been disproportionate to the revenue threat, and it is submitted that such policy response has no real role to play in the context of the financial services sector.

2.7 A further concern with the imposition of Digital Services Taxes is that they are generally not creditable taxes. They create an exposure to double taxation.

2.8 A further significant concern with the imposition of Digital Services Taxes is that they are generally applied as turnover based taxes. Consequently, loss making entities may be exposed to such taxes. It is notable that the UK's Digital Services Tax contains alternative measures for low margin or loss-making entities, which seek to mitigate these concerns (to an extent).

2.9 Digital Services Taxes in most jurisdictions apply not only to non-resident businesses, but also to domestic businesses. As such, should it be necessary to proceed, the imposition of Digital Services Taxes would need to be deductible against any domestic corporate income tax. Otherwise, double taxation arises. Again, notably the UK's Digital Services Tax seeks to address this concern.