
Certificate in Digital Economy Tax

International Taxation Challenges

Arm's Length Principle (ALP)

Related terms: Transfer pricing, related party transactions

The Arm's Length Principle (ALP) is a fundamental concept in international taxation that aims to ensure fair taxation of cross-border transactions between related parties. ALP suggests that the price for goods, services, or intangibles sold between related entities should be comparable to the price charged in similar transactions between unrelated parties in comparable market conditions. This principle is used to determine the appropriate transfer pricing for related-party transactions, preventing tax base erosion and profit shifting.

Base Erosion and Profit Shifting (BEPS)

Related terms: Transfer pricing, digital economy, tax avoidance

Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies used by multinational enterprises (MNEs) to exploit gaps and mismatches in tax rules to artificially shift profits to low-tax or no-tax jurisdictions, thereby eroding the tax base of countries where the economic activity occurs. The BEPS project, led by the Organisation for Economic Co-operation and Development (OECD), addresses 15 key action areas to tackle BEPS, including transfer pricing, digital economy, and treaty abuse.

Controlled Foreign Company (CFC)

Related terms: Substance, tax avoidance, transfer pricing

A Controlled Foreign Company (CFC) is a foreign entity that is controlled by a domestic taxpayer, usually through significant ownership or voting rights. CFC rules are designed to prevent taxpayers from shifting income to low-tax jurisdictions by requiring them to include a portion of the CFC's income in their domestic tax base. CFC rules often consider factors such as the level of economic substance in the foreign entity and the application of the arm's length principle.

Digital Economy

Related terms: E-commerce, value creation, permanent establishment

The digital economy refers to the economic activities that rely on digital technologies, such as the internet, mobile networks, and cloud computing. Digital economy companies often face unique tax challenges due to their ability to create value without a significant physical presence in a jurisdiction. This has led to ongoing discussions on how to adapt international tax rules to ensure that digital economy companies pay their fair share of taxes.

Double Taxation

Related terms: Tax treaties, withholding tax, residence

Double taxation occurs when the same income is subject to taxation in two or more jurisdictions. Double taxation can be either juridical (when the same income is taxed by two different countries) or economic (when two different types of taxes are levied on the same income by the same country). Tax treaties are designed to prevent double taxation by allocating taxing rights between countries and providing relief mechanisms, such as foreign tax credits and exemptions.

****E-commerce****

Related terms: Digital economy, value added tax (VAT), permanent establishment

E-commerce, short for electronic commerce, refers to the buying and selling of goods and services over electronic networks, primarily the internet. E-commerce has transformed the way businesses operate and consumers purchase goods and services, leading to new tax challenges related to jurisdiction, nexus, and value creation. E-commerce taxation often involves the application of consumption taxes, such as value-added tax (VAT) or goods and services tax (GST), and the determination of a permanent establishment.

****Enterprise Resource Planning (ERP)****

Related terms: Tax technology, data analytics, transfer pricing

Enterprise Resource Planning (ERP) is a business management software system that integrates various business functions, such as finance, human resources, and supply chain management, into a single database. ERP systems can help organizations manage their tax processes more efficiently by providing a unified platform for data management, compliance, and reporting. Tax functions can leverage ERP systems for data analytics, transfer pricing, and tax accounting.

****Foreign Tax Credit (FTC)****

Related terms: Double taxation, residence, source

A Foreign Tax Credit (FTC) is a mechanism that allows taxpayers to claim a credit for the foreign taxes paid on income that is also subject to tax in their home country. FTCs are designed to prevent double taxation and to encourage cross-border trade and investment. FTCs can be granted on a territorial or worldwide basis, depending on the domestic tax laws and tax treaty provisions.

****Goods and Services Tax (GST)****

Related terms: Value-added tax (VAT), consumption tax, indirect tax

Goods and Services Tax (GST) is a consumption tax levied on the supply of goods and services at each stage of the production and distribution process. GST is typically implemented as a value-added tax (VAT) and is designed to be neutral, with the tax burden ultimately borne by the final consumer. GST has been adopted by numerous countries as a more efficient and transparent alternative to traditional sales taxes and cascading taxes.

****International Tax Treaties****

Related terms: Double taxation, residence, permanent establishment

International tax treaties are agreements between two or more countries that aim to prevent double

taxation, facilitate cross-border trade and investment, and promote international tax cooperation. Tax treaties typically address issues such as residence, source, permanent establishment, withholding tax, and exchange of information. The most widely adopted model tax treaty is the OECD Model Tax Convention, which provides a framework for negotiating and implementing bilateral tax treaties.

****Permanent Establishment (PE)****

Related terms: Digital economy, dependent agent, service PE

A Permanent Establishment (PE) is a fixed place of business through which a foreign enterprise carries out its business activities in a jurisdiction. The concept of PE is a key factor in determining the taxing rights of source and residence countries, as it triggers the application of domestic tax laws and the obligation to file tax returns. The definition of PE has been expanded in recent years to include digital economy activities and the use of dependent agents and service PEs.

****Substance****

Related terms: Controlled Foreign Company (CFC), transfer pricing, tax avoidance

Substance refers to the economic and commercial activities carried out by a legal entity, typically in the context of transfer pricing and controlled foreign company (CFC) rules. Substance requirements are designed to ensure that legal entities have a genuine economic presence and are not established solely for tax purposes. Substance can be demonstrated through factors such as the presence of employees, physical assets, and business functions.

****Tax Avoidance****

Related terms: Base Erosion and Profit Shifting (BEPS), transfer pricing, double taxation

Tax avoidance refers to the use of legal tax planning strategies to minimize tax liabilities, typically by exploiting gaps and mismatches in tax laws and treaties. Tax avoidance is different from tax evasion, which involves the illegal non-payment or underpayment of taxes. Tax avoidance strategies can include the use of controlled foreign companies, transfer pricing manipulation, and treaty shopping. The BEPS project aims to address tax avoidance through the development of minimum standards and best practices.

****Transfer Pricing****

Related terms: Arm's Length Principle (ALP), controlled transactions, related party transactions

Transfer pricing refers to the pricing of cross-border transactions between related parties, such as subsidiaries, branches, or associated enterprises. Transfer pricing is a critical aspect of international taxation, as it can significantly impact the allocation of taxable profits between jurisdictions. Transfer pricing rules are designed to ensure that related-party transactions are priced at arm's length, in accordance with the arm's length principle.

****Value Added Tax (VAT)****

Related terms: Goods and Services Tax (GST), consumption tax, indirect tax

Value Added Tax (VAT) is a consumption tax levied on the value added to goods and services at each stage

of the production and distribution process. VAT is typically implemented as a multi-stage tax, with each business entity charging and collecting tax on its taxable supplies and deducting the tax paid on its inputs. VAT is designed to be neutral, with the tax burden ultimately borne by the final consumer.

****Withholding Tax****

Related terms: Double taxation, source, permanent establishment

Withholding tax is a tax levied on the payment of certain types of income, such as dividends, interest, royalties, and fees for technical services, at the source of payment. Withholding tax is typically collected by the payer and remitted to the tax authorities on behalf of the payee. Withholding tax rates and exemptions are often determined by tax treaties and domestic tax laws. Withholding tax can contribute to double taxation, as the same income may be subject to tax in both the source and residence countries.