COLUMN:
Recent Developments in International Taxation and Competition Law with the Digitalization of the Economy

In response to the progress of the digitalization of the economy, there has been active discussion on the appropriate policy for international economic activities. For example, the issue of international taxation associated with the digitalization of the economy is being discussed at the OECD, and countries are moving to introduce their own taxation measures that capture digitized economic activities (for details on a related issue, the imposition of tariffs on electronic transmission of digital content, moratorium on which has been agreed upon at the WTO Ministerial Conference, see Annex 2, paragraph 1 (2) of the Part II.). In response to the rise of digital platform providers, competition authorities are playing a central role in considering the ideal form of competition policy. This column introduces recent developments related to these issues.

1. Developments in international taxation

(1) Discussions at the OECD

As part of the BEPS (Base Erosion and Profit Shifting) project, the OECD is also discussing taxation issues associated with the digitalization of the economy, and is considering reviewing international taxation rules in response to the digitalization of the economy. The BEPS Project was launched by the OECD Committee on Fiscal Affairs in June 2012. Based on the concept of ensuring fair conditions of competition, the project aims to review the entire framework of international taxation rules so that multinational enterprises do not artificially manipulate taxable income and evade taxes, to make such rules more consistent with the realities of the world economy and corporate behavior, and to enhance the transparency of governments and multinational enterprises. In the final report of the BEPS Project published by the OECD in 2015, it was pointed out that it was difficult to distinguish the digital economy from other economies in terms of taxes, as the whole economy was rapidly digitalizing, and that consideration of corporate taxation should be continued and the results of the consideration should be summarized by 2020.

In addition, the OECD Interim Report published in 2018 pointed out the following specific issues concerning international taxation that are associated with the digitalization of the economy.

First, while economic activities can be carried out without a physical presence in a market jurisdiction, under the current international taxation rules, which largely depend on the presence or absence of a physical presence, there are cases where profits from international economic activities are not taxed in a market jurisdiction.

Second, as intangible assets such as intellectual property have become more important, it has become easier to transfer profits to countries with less taxation through transactions between related companies.

Third, as user-generated content and data create value, there is a question of how to identify the nexus (basis for taxation) when there is no physical presence in the market in which the user is located but does business using the content and data, and how to allocate taxation rights to profits generated from the content and data.

In light of this, the OECD's "Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy" published in June 2019 proposed a solution consisting of two pillars that would (1) review the rules for the appropriate allocation of taxable income to market jurisdictions (Pillar One), and (2) introduce measures to counter the transfer of profits to countries with lower tax rates (Pillar Two).

Subsequently, the OECD Secretariat submitted proposals for each of these two pillars, and at the meeting of the Inclusive Framework on BEPS (a meeting of 137 OECD member and non-member countries and regions set up to implement 15 action plans, including responses to the digitalization of the economy presented in the final report of the BEPS Project) in January 2020, an outline of Pillar 1 was agreed on in line with the OECD Secretariat proposal. The OECD welcomed the progress made on Pillar 2 and agreed to compile a final report by the end of 2020.

(i) Overview of Pillar 1

Profits regarded as ordinary profits that exceed a certain amount are regarded as excess profits, and the rights to tax part of the excess profits are allocated to market jurisdictions.

A fixed percentage of the profits is allocated to basic activities such as sales activities in market jurisdictions.

Where there are activities in a market jurisdiction that go beyond the aforementioned basic activities, that market jurisdiction will continue to be able to levy taxes under the traditional arm's length principle. At the same time, introduction of a strong dispute prevention and resolution mechanism to prevent double taxation is considered.

(ii) Overview of Pillar 2

Rules on aggregation of income: Income attributable to a subsidiary company, etc. located in a country with a lower tax rate is subject to taxation up to the minimum tax rate in the country/region where the parent company is located.

Rules on denial of tax treaty benefits: No tax treaty benefits are granted for payments subject to lower taxation rates.

Switch-over rule: A country or region that adopts the foreign income exemption method will switch to the foreign tax credit method to tax the income of a foreign branch located in a country with a lower tax rate.

Rules on payments subject to lower tax rates: Payments to affiliated companies located in countries with lower tax rates (royalty, etc.) are taxed in the country of the payer (denial of inclusion in deductible expenses).

(2) Developments in Other Countries

Prior to the conclusion of discussions among countries within the OECD on the ideal taxation rules, some countries have introduced or planning to introduce their own taxation measures.

One example is the French bill to introduce a digital services tax, which was approved by the French House and Senate in July 2019 and signed by President Macron in the same month. In response, the United States Trade Representative (USTR) initiated a Section 301 investigation into the tax, published an investigation report in December of the same year, and determined that France's digital services tax was unreasonable or discriminatory, and burdened or restricted U.S. commerce (see Part I, Chapter 2, "Unilateral Actions and Extraterritorial Application" (1)). Based on this determination, the USTR proposed trade restrictions under Section 301 of the Trade Act on French products and services and solicited public comments, but the tense situation temporarily calmed down when France announced that it would defer the collection of the digital services tax.

In December 2019, Turkey also published a bill to impose a 7.5 percent tax on revenues generated in Turkey from digital services, such as digital advertising services and sales of digital content (subject to exemption if revenues generated from the services for the previous fiscal year (i) in Turkey are less than TRY 20 million or (ii) worldwide are less than EUR 750 million), which will enter into force in March

2020. In addition, there are a number of countries that have introduced or are considering tax measures in response to the digitalization of the economy, including the United Kingdom, which plans to introduce a digital services tax in April 2020.

2. Developments in Competition Policy

Responding to the rise of digital platform providers and the increasing importance of data in economic activities has also become an important topic in the sector of competition policy. In 2015, the European Commission launched an investigation into the so-called most-favored-nation clauses in Amazon's e-book distribution contracts, citing concerns over violations of EU competition law. This is a recent example of an actual case where the act of a digital platform provider has become an issue. As a result, in 2017, Amazon made a commitment to the European Commission that, in response to the Commission's concerns, it would not impose a clause requiring publishers to offer Amazon similar non-price and price terms and conditions as those offered to Amazon's competitors.

As part of its efforts to build a digital single market, the EU is taking the lead in considering regulatory issues related to online platforms, etc. The report on the e-commerce sector inquiry conducted as part of these efforts published in May 2017 points out that the growth of e-commerce has led to the emergence and evolution of business practices that give rise to competition law concerns, such as selective distribution systems and vertical restrictions on sales prices and methods, due to the ease of monitoring the quality of distribution services and sales prices. In light of this, the report concludes that the Commission will enforce EU competition law with a view to targeting the most prevalent of these practices that have a negative impact on competition and cross-border trade, and will strengthen cooperation between national authorities in the region to ensure consistent application of EU competition law to e-commerce-related business practices.

In addition, in July 2019, as a rule to offer a transparent, fair and predictable online business environment, the "Regulation on Promoting Fairness and Transparency for Business Users of Online Intermediation Services" was implemented, which imposes an obligation on online intermediation services and search engines to disclose information on main parameters that determine transaction terms and search rankings. Against this backdrop, in Japan, the "Fundamental Principles for Rule Making to Address the Rise of Platform Business" was formulated in December 2018 in order to improve the rules in response to the rise of the platform businesses. In light of this, the "Guidelines Concerning Abuse of a Superior Bargaining Position in Transactions between Digital Platform Providers and Consumers that Provide Personal Information, etc." formulated by the Japan Fair Trade Commission was published in December 2019. The Guidelines summarized the concept of the act of acquiring personal information, etc. on digital platforms provided by digital platform providers or using such acquired personal information, etc., on the grounds that (i) digital platforms are expected to expand and promote monopolization and oligopolization through their characteristics such as network effects, low marginal costs, and economies of scale, etc.; (ii) cycles which maintain and enhance competitive advantages are expected to be created by further accelerating the accumulation and use of data by digital platform providers; and (iii) there are some concerns over the acquisition or use of consumers' personal information, etc. by digital platform providers.

In addition, given the increasing importance of data utilization in business activities in the context of IoT and the advancement of artificial intelligence-related technology, and the need to consider competition policy issues in order to promote data utilization, the "Study Group on Data and Competition Policy" was established within the Japan Fair Trade Commission's Competition Policy Research Center, and in June 2017, a report of the Study Group summarizing the issues concerning the application of the Antimonopoly Act and competition policy was published.

3. Future Challenges

In line with the progress of the digitalization of the economy, it is necessary to continue to consider and take measures to ensure that appropriate taxation is made and competition law can properly fulfil its role.

With regard to dealing with the issues of taxation associated with the digitalization of the economy, it is necessary to engage in international discussions with a view to maintaining and improving the international competitiveness of Japanese companies by creating a fair competition environment among them, clarifying the scope of application of the new rules, and preventing excessive administrative burden and double taxation.