

Cloud IT and Tax IT

The International Taxation Challenge of Cloud Computing

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Advances in Information Technology (IT) have allowed the global economy to become more sophisticated. There is now more flexibility than ever in operating worldwide businesses, making it possible to construct ingenious corporate structures whose sole purpose is to create “stateless income” by exploiting legitimate local and international tax law—in essence, allocating income for tax purposes, representing no real economic substance. Although the risk of corporate and personal income tax erosion in the wake of the IT Revolution was until recently non-existent, Cloud Computing technology, a subset of IT, is currently disrupting operating and employment methods. Since the nature of the Cloud allows manipulation regarding the location of the company, it is important to create an international mechanism that will neutralize any negative incentive to locate the company in a territory merely for tax considerations. With the ability for corporations and individuals to be located in any jurisdiction, an organization can decentralize its IT infrastructure by distributing its network servers in multiple jurisdictions around the world, while keeping the command and control of these servers easily accessible from any device with an Internet connection and a standard browser. This significantly impacts three sectors: Software, Hardware, and Human Resources. The present study focuses on U.S. and international tax implications of the software and hardware sectors (Software as a Service—SaaS, Platform as a Service—PaaS, and Infrastructure as a Service—IaaS). It reviews proposals from eminent scholars, and uses example scenarios along with case studies to determine the source of Cloud Computing income, since each jurisdiction makes a contribution along the way. Instead of regulating new source rules for the taxation of income, courts have traditionally used analogies to solve problems ad hoc, resulting in absurd consequences and a game of cat and mouse to close the loopholes as soon as they are discovered. Thus, the key issue is whether the international tax system can continue to operate in its current form. In essence, Cloud Computing is forcing decision-makers to determine how to deal with the

new taxation challenges. The time has come to modify the outdated rules that have dominated the tax system since the beginning of the 20th century, and establish new principles to maintain the international consensus for taxation.