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Task Force on the Digital Economy
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Submitted by email: TFDE@oecd.org

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REQUEST FOR INPUT ON WORK REGARDING THE TAX CHALLENGES OF THE DIGITALISED ECONOMY

Dear Members of the Task Force on the Digital Economy,

Thank you for the opportunity to provide input on the tax challenges of the digitalised economy. As an initial matter, however – and while this may seem a semantic point it is, in fact, a critical one – we believe it would be better to refer instead to the "digitalising" economy rather than the "digitalised" economy. Although the changes over the past five/ten/twenty years have been dramatic, our members feel that we are standing on the threshold of changes of orders of magnitude larger than those we have seen so far. In that context, the interim report that the TFDE is to deliver to the OECD should be a review of where we have come from, and where we may be going, and an invitation to start a conversation on the implications of that. We do not feel it would be productive for the report to focus on a set of recommendations fixed in present and, inevitably, heavily influenced by the past.

Twenty years ago, with remarkable foresight, the OECD worked on principles eventually articulated in the Ottawa Taxation Framework that ensured that growth-suppressing national taxes would not be imposed on the nascent digital sector. Twenty years later we can say, without doubt, that this has been one of the most significant achievements of the OECD in its half century of existence. Today – thanks to that framework – digitalisation is revolutionizing economies, business models, and the lives (at work and at home) of billions of citizens. This will have dramatic effects of every corner of every economy – including on tax bases and the ability of governments to raise the revenues their citizens expect them to raise. The conversation of the past five years has – appropriately – been focussed on dealing with the issue of Base Erosion and Profit Shifting (including in relation to the digital sector). But with the fifteen recommendations having been made, approved, and now beginning to be implemented, we need to turn to the challenges of the future, and the overwhelming need to make sure the changes being wrought by digitalisation promote growth and employment, including through cross-border trade and investment.

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However, we see significant issues with each of the proposed options to address what are perceived as the direct tax policy challenges of the digitalising economy in the Request for Input. Double taxation, increased compliance burdens, conflicting unilateral interpretations, potential treaty conflicts, and increased taxation for low margin and loss making businesses will suppress rather than promote the growth that digitalisation can offer.

Instead of rushing towards imperfect solutions, there needs to be a serious and sustained conversation, not just between governments but with the businesses, large and small, that are driving, and accelerating this digital revolution. There is no body better suited to this task than the one that gave us the Ottawa Framework – the OECD. But this must be a deliberative and considered conversation. It cannot be completed in a few months. Furthermore, it must be a conversation which – unlike BEPS, where business was the "problem" – involves a close partnership between the OECD, a broad range of national governments, and business to try to discern what the future might look like. Only with business closely involved is there any hope of even vaguely comprehending what the next five to ten years may bring, and how growth can best be promoted and protected while still enabling governments to raise tax revenue.

At the heart of this conversation – and, obviously, a source of contention between countries – is the fundamental question of where value is created. BIAC believes that it will take time to establish what **must** be a multilateral consensus on this issue. At the same time we understand that this conversation cannot take for ever. BIAC stands ready, therefore, to fully engage in that sustained conversation, and to work constructively and cooperatively over the next three years, into 2020, to help reach a truly multilateral agreement that sets a new pro-growth tax framework that meets the needs of all stakeholders.

Sincerely,

Will Morris

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Chair BIAC Tax Committee

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General Comments

BIAC would like to start by reinforcing its support for the conclusion drawn in the Base Erosion and Profit Shifting ("BEPS") Action 1 Report that there should not be a separate taxation regime for the "digital economy". We, of course, acknowledge that there are important issues concerning the digitalisation of our economies but considerable care must be taken to ensure that measures intended to address the taxation of the digital economy do not lead to serious distortions in markets and global value chains. A tax system specifically designed to target "pure" digital companies, rather than a system designed to be neutral across all sectors, will inhibit cross-border growth and investment, foster uncertainty, and increase double taxation. One of the OECD's core principles is to reduce barriers to the expansion of trade, and instances of double (or multiple) taxation on one stream of revenue threaten this principle.

BIAC understands that much of this conversation is being conducted at a political level, and acknowledges the political pressure under which the TFDE is operating but we strongly believe that the only path towards a solution for all stakeholders is if the overall discussion is rebalanced to focus on encouraging the growth of the digital economy rather than the threat it may pose to tax revenue. There is a tremendous opportunity at present to shape international tax law in a way where tax can be a catalyst for cross-border investment and growth and not only for large multinationals but also for small and medium-sized enterprises ("SMEs"). However, without a change to the current narrative, we risk having the opposite impact.

The growth of the digital economy has been one of the greatest economic success stories in the past twenty-five years with a remarkable increase in connectivity, technological leaps in developing countries, and new opportunities for multinationals and SMEs. The OECD must work to rebalance this discussion amongst its member countries by highlighting how enriching this growth has been for many people in many countries and the considerable risk that tax could become a monumental barrier to future growth if these issues are not carefully addressed.

BIAC acknowledges that the fundamental issue at the heart of the debate on taxation of the digital economy is the pressure that digitalization places on determining where value is created. This is an enormously difficult area that must be addressed through a global agreement and not through unilateral measures, whether or not these measures are considered short-term solutions. The central tenet of the BEPS Project was to establish an international tax framework that would provide for a level-playing field under which profits are taxed where economic activity and value creation occur. As such, significant time and effort was spent during the BEPS process determining where value is created and now it appears that those standards are considered by some to no longer be viable before we have seen their full implementation. It will take time for the considerable changes advanced through the BEPS Project to be implemented so it would be a costly mistake (at the expense of global trade and growth) to abandon these principles now. It is imperative that the OECD promotes patience and thoughtful analysis despite the upcoming deadlines mandated by the G20 or pressure from member countries for a quick fix.

A primary concern among the business community regarding the unilateral measures that have been proposed or already adopted is the lack of consideration for the impact these measures will have on the operation of traditional and non-traditional digital businesses. There are a wide range of diverse business models within sectors, geographies and scales, and these business models have degrees of

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interdependence and crossover but also separate, commercially-led strategies that are responsive to the needs of their stakeholders yet constrained by market forces, competition, and regulation. Tax policy choices should encourage business decisions to be taxed neutrally, but the reality is that if measures are proposed and adopted that do not align with emerging business models, this will have an impact on business and investment decisions.

As previously mentioned, BIAC understands the political pressures for the TFDE G20 interim report to recommend proposed solutions for taxing the digital economy. However, as we have tried to make clear throughout our response, we should consider ourselves to be in the infancy of the discussion around taxing the digital economy. Therefore, an analysis of the scope and impact of various proposed solutions (and, a fortiori, any recommendations) is premature. For instance, there seems to be no consideration for how any proposed solutions would impact an overall goal of the OECD to work towards a uniform international tax framework across jurisdictions and business sectors. That being said, we believe there are very clear principles that should drive any proposed solution. Specifically, BIAC continues to support the principles established by the Ottawa Taxation Framework of neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility as the ideal starting point for the TFDE. We also agree with the OECD's BEPS Action 1 report that sustainability and proportionality are also key principles against which proposals should be measured.

The introduction of either a "virtual PE", withholding tax on digital transactions, or equalization tax on the turnover of digital companies would clearly violate these principles (more information is included in our specific responses questions below on this conclusion). There are clearly fundamental problems with each of these proposals, all of which are dangerously blunt tools fashioned to enable "source"[1] countries to raise additional revenue (which could result in double/multiple taxation on the same revenue streams), rather than considered measures to address either BEPS concerns or the broader tax challenges posed by the digitalization of the economy.

In fact, we observe that each of the measures (and particularly the proposals regarding taxes levied on turnover) undermine one of the key objectives of the recently concluded BEPS Project – to "better align rights to tax with economic activity". For example, the BEPS Project sought to realign the allocation of taxing rights away from contractual allocation of risk, toward where such risks are managed. It is hard to see how any of the three proposals would further, rather than hamper, this objective.

It is equally unclear that any of the proposals have been suggested with growth in mind, as seems to be an expectation of the G20 Finance Ministers. **Together, we believe that these observations reinforce the need to take an appropriate period of time with multilateral engagement – including crucially with business, – in order to develop more pro-growth and sustainable multilateral solutions.**

[1] BIAC increasingly finds "source" and "residence" to be very unhelpful terms. They connote a binary world of capital-importers and -exporters, rich and poor, developed and developing, whereas (not least because of digitalization) a serious conversation about value creation should allow for a more nuanced picture, and range of possibilities.

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BIAC strongly urges the TFDE to work to change the narrative to one of pro-growth and resist the political pressure for immediate, drastic measures when it is clear from the complex issues addressed in this RFI that there is still a great deal of analysis required in this area. We continue to believe that the OECD is the only organization that can drive a consensus solution that satisfies all countries, and we stand ready to continue to support the OECD in its endeavors.

Responses to Questions

A. Digitalisation, Business Models and Value Creation

1. Please describe the impact of the digitalisation process on business models, and the nature of these changes (e.g., means and location of value creation, organisation, supply chains and cost structure).
    - There are a number of different ways in which digitalisation has impacted business, including:
        - Many "pure" digital businesses are now prominent players in local economies and the global economy. Such businesses provide goods and services that do not have "traditional" counterparts to which they could be compared, because they offer goods and services that would not exist without digitalisation. Such businesses tend to be innovative and highly dependent on IP generated early in their life cycle, and continued investment and innovation throughout their life cycle. Whilst they may require localisation, this can often be delivered in different ways (i.e. remotely) than was the case for traditional business models.
        - Digitalisation has given "traditional" businesses much more freedom in where they locate their assets, functions and resources. This leads to more efficient business outcomes due to (i) options for employing better quality resources, and (ii) options for employing cheaper resources (which will include any tax savings/costs that may arise as a result of the location of this resource).
        - Many traditional B2B businesses are now also able to deal with and communicate with their end customers/users without intermediaries. This has empowered new sales channels which have impacted supply chains and pricing structures of different business models in different ways. Also, though, this has increasingly resulted in such companies needing to invest in developing their brands and building connections with consumers and communities.
        - Similarly, some (but not all) "pure" digital business models and digitalised "traditional" business models have become multi-sided in nature, which is not a key observation of historical business models. In such cases, rather than developing and providing products and services to customers in multiple locations, the business model is a platform that connects users/customers in different locations, or at least centrally benefits from the interaction of dispersed users/customers without facilitating a direct interaction between the two. Coupled with the rise of social media has also contributed to more "customer-centric" business models; there are greater risks and rewards to failing or exceeding customers' expectations.

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    - Whilst in some industries barriers to access remain high (which includes, but is not limited to “pure” digital businesses), the ability for customers and consumers to select from a broader range of international suppliers of goods and services, delivered through a broader range of mechanisms (which can be increasingly bespoke), has driven greater competition, and consequently more innovative and customer-centric products, services, and delivery mechanisms. Again, this may be delivered through cost savings (or alternative payment methods such as through agreeing for companies to use data and/or show advertising) or better/new products and services.
    - Increasingly, business offerings have become (and continue to become) more service based. In delivering this, software is increasingly a crucial infrastructural element and key value driver relative to physical products and hardware.
    - New entrants are competing with and working with existing businesses on an unprecedented scale, resulting in more frequent and swifter disruption to business models than has traditionally been seen.
- These changes have resulted in greater efficiencies in business models and a redistribution in the traditional allocation of functions between economies. In some instances the provision of digital services does not necessarily generate revenue but remains critical as a means for providers of traditional products and services to remain relevant in the digital economy. The impact has been a greater degree of choice (in supplier, delivery method and pricing structure), better products/services, and even new product/services for customers and consumers.
- Other emerging areas of importance, such as Big Data, Internet of Things, 3D Printing, and “Everything” as a Service (over cloud or virtual platforms) are increasingly important for global business. Whilst the key value of such offerings is increasingly found in software, we do not believe that this fundamentally changes the business decisions and business models outlined above.

2 What role does IP play in highly digitalised businesses, and what are the types of IP that are important for different types of business models (e.g. patents, brands, algorithms, etc.)?

- Digitalized businesses are not necessarily more IP-intense than traditional businesses. IP is clearly a key value driver for most businesses (traditional and “pure” digital) and this question depends very much on individual businesses and business models. It would therefore be a mistake to assume as a starting point that digitalized and non-digitalized business models can be differentiated in this way.
- As a general rule it could be said that patents are more important for “traditional” business models, brands are of increasing importance for all business models, and algorithms are more important for “pure” digital businesses (but are also increasingly important as all businesses move to digitalised delivery).
- For example, under traditional “service” models, a business may have historically needed to send out a human to diagnose a problem with a machine, and propose a fix. Under a “digitized” model, the software/IP may now be able to remotely diagnose the same problem, and then either send a repair person with the part to install, or ship the part to the customer and remotely guide them through a self-repair process. The same (or greater) value is being created in such instances, but it is the DEMPE of the algorithms that generates this value.

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3 How are sales operations organised across different highly digitalised business models? What are the relevant business considerations driving remote selling models, and in which circumstances are remote selling models (as opposed to local sales models) most prevalent?

- As noted above, as a result of digitalisation, businesses now have much more freedom in where they allocate their assets, functions and resources. This leads to more efficient business outcomes due to (i) options for employing better quality resource, and (ii) options for employing cheaper resource (which will include any tax savings that may arise as a result of the location of this resource).
- The key driver for remote selling models is cost reduction in combination with increased quality. If a business stream can be managed remotely, without having to visit different locations/sites, support will become less expensive and it will be easier and more cost effective to centrally monitor the business from a remote location. Increasingly, this is also the case for all business models. Bespoke solutions regarding the physical presence of employees and assets (i.e. warehouses, stock, servers) are required for each business, and will be based on an analysis of quality and cost of resources relative to the impact on delivery.
- It is also of note that the level of physical presence related to the selling/marketing activity in-country depends on a business' growth phase and its level of maturity. Remote selling of services may not require any physical presence of supporting employees, but to achieve any scale, some physical presence is still generally required (and some business models rely on signing up users/customers online to benefit from offline (physical) services).
- For example, there are some industries where proximity to the customer is important (e.g. delivery of perishable goods which may expire, or computerised trading platforms through which fractions of a second in transmission time may be critical). Whilst some businesses in such industries may make this their USP, others may choose to locate functions elsewhere and offer better quality, or cheaper (but slower) services.

4 What is the role of data collection and analysis in different highly digitalised business models, and what types of data are being collected and analysed?

- Data can be used in the same way as any other information, by individuals, to create value (e.g. through developing tools that use the data to improve predictability of maintenance and operation of industrial assets, or through combining with other data and analysing in innovative ways to identify trends). However, raw data does not have value in and of itself.
- See also below answer to question A5.

5 Is the establishment and operation of such global (or at least cross-country) user networks new and specific to certain highly digitalised business models, and what are the potential implications for value creation?

- No. Increasingly, "traditional" businesses also need to engage with their customers (and end consumers, where relevant) digitally and directly, and increasingly communities of users and customers are important to their success (see QA1 above).
- The impact on value creation depends on the nature of the business and the business model employed.

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- Where users are simply providing data to their suppliers in order to improve the service, this may be collected much more easily (and combined in new and innovative ways that result in better outcomes), but this is not fundamentally different to a customer completing a survey or providing feedback and sending it to its supplier under traditional business models. This data does not generate additional revenue but is simply required for businesses to remain relevant in the sale of traditional products.
- Users may receive valuable services (e.g., maps, email, connectivity tools, etc.) for free in exchange for providing personal data. Where users are supplying their personal data in return for access to a "free" (e.g. paid for through advertising) service, this is again not new; traditionally marketing companies have collected a wide range of data on individuals and markets through surveys and market research to enable advertisers to be more effective in how and to which communities they target (although, as above, digitalisation may allow it to be combined in new ways that result in better outcomes). Under such traditional methods of data collection, those who collect the data would create value where their functions, assets and risks that analyse that data are located.
- We therefore question whether the number of "users" really does change the location of where the value is created.

6 Please describe how you see business models evolving in the future due to advances in information and communications technology (e.g. Artificial Intelligence, 3D printing).

- We believe it would be imprudent to assume that it is possible to further predict product/service development, let alone the business models that would deliver them. Many of the products and services that we see today could not have been accurately predicted as little as twenty-five years ago. Even for those products and services for which we expect to see developments in the near future, industry experts are divided as to their usefulness and the impact that thy will have on our lives and economies.
- However, technology advancement by itself has not fundamentally changed how enterprises generate revenues. Rather technology and automation may increase operational efficiencies or replace certain routine/administrative functions. Because servers and software programs/algorithms now replace what used to be offices with humans performing tasks, certain business functions are now more mobile. For example, e-commerce selling is similar to catalogue selling, except now, order and payment processing can happen on a server (which can be located anywhere) rather than in an office with humans taking orders and processing payments.
- We would expect businesses to continue to make investment and product/service decisions based upon where the factors critical to the success of their businesses can be performed most efficiently and at the lowest cost. The current trend in this vein appears to be that traditional jobs can increasingly be automated or performed remotely, and that new opportunities are provided by new innovations.

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B. Challenges and Opportunities for Tax Systems

1 What issues are you experiencing with the current international taxation framework? (e.g. legal, administrative burden, certainty)

- BIAC has commented extensively on the difficulties that businesses face in the international tax system. Administrative burden and uncertainty are of particular importance to our members, particularly as a result of the BEPS Project and including particularly interpretation of Transfer Pricing Guidelines, application of anti-abuse provisions, and the fundamental changes to the long-standing concept of permanent establishment.
- In addition, it would be valuable if the OECD – as the tax standard setter -- could help bring more coherence to the tax system by standardizing the interpretation of phrases and key terms. For example, a consensus on the definition of "income tax" would make it more difficult for countries to levy tax on income while asserting that it is not an income tax (e.g. that it is a penalty). Another example would be the definition of "royalty", and the importance of an analytical approach based on an analysis of differences between a user receiving a right to use copyrighted software against a user receiving a right to the copyright itself.

2 Digitalisation raises a number of challenges and opportunities for the current international tax system. In particular:

a. What are the implications of highly digitalised business models and their value chain on taxation policy? In particular:

i. What impact are these business models having on existing tax bases, structures of tax systems and the distribution of taxing rights between countries?

ii. Are there any specific implications for the taxation of business profits?

- See in particular our response to A1 above.
- The additional options that taxpayers have regarding where to locate their functions, assets and risks allows them to make investment and business decisions that deliver better outcomes and lower costs.
- This, of course, has an impact on the tax bases of countries who previously benefitted from investment because of (in part) their geographical location or proximity to other functions (or markets).
- Conversely, countries that have embraced the digital economy and provided the tools (e.g. digital infrastructure) and climate (e.g. regulation, tax regime) that encourages such investment have benefitted from increased investment.

b. What opportunities to improve tax administration services and compliance strategies are created by digital technologies?

- We expect that there are numerous ways in which digitalisation could assist taxpayers and tax authorities in both overall experience and levels of compliance.

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- However, experiences of taxpayers to different countries' implementation strategies has been mixed. Like any project, in order to be effective, introduction of such systems need to have clear and realistic objectives outlined and considerable thought given to practical application in advance, and to be introduced in phases to allow taxpayers and tax administrations to become accustomed to them (and for any issues to be dealt with quickly).
- We believe that innovations such as online tax accounts, blockchain, risk assessment, greater automation (including artificial intelligence), greater access to data and decision makers, e-payments, cashless payments, and real time working, could combine to provide taxpayers with systems that are easier to use, more visible/transparent, and more secure to interact with. It would also give tax administrations the data they need (from taxpayers or other tax administrations / stakeholders) in more accurate and more timely ways.
- We would welcome opportunities to discuss all of these areas with the Forum on Tax Administration.

C. Implementation of the BEPS package

1 How have the various BEPS measures (especially those identified as particularly relevant for the digital economy – i.e. BEPS Actions 3, 6, 7 and 8-10) addressed the BEPS risks and the broader tax challenges raised by digitalisation?

- It is too early to determine, which is why we understood that the OECD had originally planned to report back in 2020.
- In particular, we note that:
    - Regarding Action 3, even frontrunners such as the EU are still implementing changes to domestic rules.
    - Regarding Actions 6 and 7, the MLI has not yet been ratified in sufficient countries for it to enter into force.
    - Regarding Actions 8-10, the OECD is still completing follow-up work in this area (and even in relation to completed work, the revised guidance has only recently been finally approved and published).

2 What has been your experience from the implementation of these collection models (e.g. compliance, impact on business operations)? What are some examples of best practice in this area?

Business experiences

- Following the 2015 BEPS Action 1 report on 'Addressing the Tax Challenges in the Digital Economy', a growing number of countries have either already implemented new VAT/GST rules to tax the import of digital services into their territory, or they have announced plans to do so in the near future. Many of the new collection models follow, at a high level, the general principles of taxation set out in the OECD's VAT/GST International Guidelines – i.e.:
    - The place of taxation for digital services is where the customer is established, has his permanent address or usually resides.

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  - For B2B supplies, the reverse charge is the most efficient means of accounting for the VAT/GST due, because the foreign supplier is not obliged to register for VAT/GST purposes in the customer's jurisdiction.
  - For B2C supplies, local VAT should apply, achieved via the local registration of the non-established business in the place where the customer is deemed to be located.
- However, beyond the general framework set out above, the speed and scale at which changes are being introduced around the world has produced a wide variety of challenges for businesses operating in the global marketplace, even where governments have tried to keep compliance obligations for foreign vendors as simple as possible (e.g., by adopting simplified registration procedures). This is largely caused through the globally inconsistent implementation of the abovementioned principles into respective national laws, as a result (mainly) of the diverse local legal and administrative tax environment (VAT/GST laws, procedural laws and administrative processes).
- The result, even if overall the broad aims of the rules are similar, is a great multiplicity of legal and administrative practices established by different countries, including different registration platforms and collection mechanisms. Our experience is that even simple and flexible rules can still result in significant complexity if there is limited co-ordination between different countries in addressing what are effectively global issues. Therefore, in our view, more consistency is required internationally to ensure that there is greater efficiency and cost effectiveness whilst safeguarding tax revenues. We also believe that a better exchange of information between tax authorities could ease the compliance burden for foreign businesses, particularly when it comes to the registration process – e.g., basic data about the foreign vendor (business name, address, commercial activity etc.) could be shared between the tax authority where the business is established and the tax authority where the business is obliged to register in the course of making digital supplies to consumers.
- It should also be noted that there are some countries that have not followed the OECD framework set out above. In particular, businesses have experienced difficulties in those countries that do not make a distinction between B2B and B2C transactions according to the status of the customer. Whilst from a theoretical approach this may simplify the legislative process, in practice it creates unnecessary administrative burdens and cost for businesses that only provide services in a B2B context (as well as for tax authorities), particularly when considering the fact that the majority of business customers will in any case be in a position to fully recover the VAT charged.
- From a Direct Tax perspective the BEPS Action 7 and Actions 8-10 recommendations have resulted in some businesses changing their business models (e.g. move to buy/sell contractual models) to ensure that they do not face undue PE risk and are compliant with transfer pricing guidelines[2].

[2] Although we note that in some cases, such a move from commissionaire to buy-sell could actually increase the US tax exposure for US MNCs.

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Best practices

- From business experiences to date it is possible to identify a number of best practices:
    - In general, a simple and flexible tax regime (in terms of the way businesses are required to collect the tax) is key in order to ensure that trade remains as unaffected as possible by VAT/GST considerations, thereby helping to foster the tremendous potential of the digital economy to enhance economic growth whilst simultaneously maximising tax revenues – a clear win-win for all. With this in mind, early consultation with business is crucial in order to understand business models and processes and, therefore, how best to optimise the legislative and administrative framework. We are pleased to report that a small number of countries have been very proactive in adopting an open and consultative approach, but certainly more could be done in this respect.
    - On the basis that the rules ultimately impact foreign businesses, once the legislative framework is finalised, determining an effective communication strategy is critical to success in order that non-established businesses know that the rules exist and understand how to comply with them. Hand in hand with this, sufficient lead time needs to be set aside so that business and tax authorities are able to make adequate preparations for implementing the rules. From a business perspective, 12 months is generally considered a minimum length of time for making ready, although longer may be required if significant IT systems development is necessary.
    - The OECD work being undertaken on the (as yet unpublished) implementation package ('Design and operation of efficient foreign vendor VAT/GST collection mechanisms'), and into which Business at the OECD (BIAC) has given business input via the OECD VAT/GST TAG process, is critical for the consistent implementation and application of the framework set out in OECD VAT/GST International Guidelines. Looking ahead, we would encourage governments to analyse the implementation package in detail and we very much hope that the guidance will introduce a host of legal and administrative best practices to those countries envisaging new digital taxation regimes and will also assist those countries that have already adopted digital taxation regimes in considering whether there are ways to improve their current arrangements. As ever, BIAC would be pleased to consult with governments to highlight the key business aspects contained in the report and to share practical information on business models, systems and processes. Furthermore, we would recommend that any VAT/GST digital policy considerations/actions should be benchmarked against the OECD implementation guidance in order to drive a greater level of consistency.
    - Countries should be encouraged to introduce tools designed to alleviate the VAT/GST compliance burden facing particularly foreign businesses. These tools should include digital measures (e.g., allowing for remote e-filing), sensible registration thresholds, and safeguards against unnecessary additional registrations with no need for local bank accounts, local fiscal representation, local invoicing, and local language requirements. Such

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measures could significantly contribute to achieving greater levels of certainty and consistency.

Conclusion

- The critical points for a successful digital VAT/GST strategy can be summarised as follows:
    - Simplicity and flexibility - Day by day the digital thread runs through more and more businesses across all industry sectors - the traditional economy and digital economy are now, to all intents and purposes, inextricably linked. Business models vary widely and there is no one size fits all approach. Therefore, in order to encourage growth and safeguard tax revenues, digital taxation rules need to be simple and flexible to allow businesses to comply easily today, and to accommodate new digital business activities tomorrow.
    - Consistency - Simple and flexible rules can still result in complexity if overall at a global level there is limited co-ordination between different countries. The OECD work being undertaken on the implementation package is critical for the consistent implementation and application of the framework set out in OECD VAT/GST International Guidelines.
    - Business consultation - It is vital to design and implement new rules for taxing the digital economy in partnership with business. In the majority of cases businesses merely act as VAT/GST collectors, thus their knowledge and understanding of models, systems and processes is key to delivering an efficient and cost effective regime.
    - Sufficient lead time - The introduction of new VAT/GST rules to tax digital supplies drives major organisational changes across all business sectors. In line with this, business needs time to implement and execute with quality, including setting up the right internal procedures and processes, as well as configuring IT systems and compliance tools. This is also true for tax authorities. Therefore, we strongly recommend that governments grant sufficient lead time between the date of publication of new VAT/GST laws and their effective date of implementation.

Final remark

- As a final point, one currently highly debated topic is the role of digital platforms and intermediaries in the VAT/GST collection process. Some governments have already taken steps to implement measures in this area, while others are in the process of considering whether and how best to take action. The commercial reality is that there is a wide variety of new and constantly evolving business models with different parties involved in the digital value chain all performing different functions. As a result, there is no one size fits all solution, and the practical aspects have to be analysed in detail in order to determine who can reasonably act in the collection process (e.g., as a tax collector or information provider for the tax authorities) and who cannot. This matter is currently being discussed in the OECD VAT/GST TAG process with BIAC giving commercial and practical input. Above all, it is important to find solutions that on the one hand safeguard tax revenues and on the other hand make it as easy as possible for business to comply, which is key for ensuring a global level playing field and promoting growth in this rapidly expanding market.

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D. Options to address the broader direct tax policy challenges

1 The 2015 Report outlined a number of potential options to address the broader direct tax challenges driven by digitalisation. Please identify and describe the specific challenges associated with the application (e.g. implementation, compliance, neutrality) of these options. What are the advantages and disadvantages of these options, including from an administrative and economic perspective, and how might some of the disadvantages be addressed or mitigated through tax policy design? In particular, comments are welcome on the following specific issues:

a. Tax nexus concept of "significant economic presence":
   i. What transactions should be included within its scope?
   ii. How should the digital presence be measured and determined?
   iii. How could meaningful income be attributed to the significant economic presence and how would such an approach interact with existing transfer pricing rules and profit attribution rules applicable to the traditional permanent establishment?
   iv. How could such a measure be efficiently and effectively implemented in practice?
   - We do not consider that these are appropriate questions because we have fundamental concerns over the appropriateness of the method.
   - However, we have the following comments on the tax nexus concept of significant economic presence (with particular reference to the Ottawa/OECD's tax framework design concepts):
     - The introduction of a "significant economic presence" threshold would untether the PE concept from physical presence and thus be a significant departure from the existing rules, and be incoherent with existing profit attribution rules based upon the value of significant people functions located in a country. The current attribution rules have been a subject of considerable debate in recent years, including particularly as the OECD seeks consensus following the changes to the threshold from BEPS Action 7. An even more fundamental change to the threshold would result in even greater difficulty in achieving consensus, and result in unilateral interpretations and even greater inconsistencies.
     - Any such move would not be in line with the neutrality concept unless it applied equally to all businesses (and would, in any case, require arbitrary lines to be drawn).
     - Any changes to the nexus threshold required to trigger the existence of a PE would also need to be accompanied by a change to treaties and to the underlying profit attribution guidelines in order to be coherent. The challenges that businesses (and the OECD) have faced in finalizing this element of the BEPS package lead us to the conclusion that any such changes should be dealt with as an entire package, agreed globally, rather than divorcing the agreement of the threshold from the agreement around attribution principles or allowing divergences between countries. Without this coherence, changes regarding the definition of a PE

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will pose incredible challenges regarding administration, the allocation of profits, double taxation. These would undoubtedly result in significant controversy and would discourage the expansion of digital goods and services into remote economies, thus adversely affecting economic growth.

- Given the lack of detail (even at a conceptual level), it is hard to comment on whether the proposals could meet the efficiency, simplicity, and certainty concepts, although the difficulties already faced by businesses with the existing threshold (and the fact that the OECD's latest Discussion Draft suggests that there will be situations where there is little or no profit to be allocated) indicate that this will be very challenging.
- Regarding flexibility and sustainability, it is challenging to say with certainty whether a new threshold will be more resilient to changes in business models than the existing thresholds, but given our comments above about the inherent uncertainty regarding future developments in business as a result of the digitalisation of the economy, that seems very unlikely.
- Finally, as noted in the BIAC response to the recent OECD Discussion Draft on profit attribution to PEs, lowering of PE thresholds results in a tremendous need for administrative simplification. Further deviations from the traditional concept of a PE will only exacerbate that need as companies with a handful of remote transactions in a particular jurisdiction could be required to meet considerable compliance obligations that may ultimately drive underlying business decisions.

b. Withholding tax on certain types of digital transactions:
   i. What transactions should be included within its scope?
   ii. How could the negative impacts of gross basis taxation be mitigated?
   iii. How could the threat of double taxation be mitigated?
   iv. How could such a measure be efficiently and effectively implemented in practice?
      - We do not consider that these are appropriate questions because we have fundamental concerns over the appropriateness of the method.
      - However, we have the following comments on digital withholding taxes (with particular reference to the Ottawa/OECD's tax framework design concepts):
         - A withholding tax on digital transactions presents considerable issues in terms of neutrality, scope, and administration in particular.
         - The concept of neutrality is clearly violated by applying a withholding tax only on cross-border e-commerce transactions and that would arise only after addressing the difficulty of properly scoping which digital transactions this withholding tax could be applied to.
         - Many of these transactions are likely to be business-to-consumer ("B2C") and very low value. It is unlikely that individual consumers

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will collect and pay over a withholding tax, creating a significant burden on financial institutions to act as a tax collector.
  - Given the lack of detail (even at a conceptual level), it is hard to comment on whether the proposals could meet the efficiency, simplicity, and certainty concepts.
  - Regarding flexibility and sustainability, it is challenging to say with certainty whether a new definition will be more resilient to changes in business models than the existing thresholds, given our comments above about the inherent uncertainty regarding future developments in business as a result of the digitalisation of the economy.
  - Regarding proportionality, effectiveness, and fairness, it is difficult to conceive how turnover based taxes (which hit businesses with different margins in the same way) could be conceived to be fair, and would likely create an uneven playing field.

c. Digital equalisation levy:
   i. What transactions should be included within its scope?
   ii. How could the negative impacts of gross basis taxation be mitigated?
   iii. How could the threat of double taxation be mitigated?
   iv. How could such a measure be efficiently and effectively implemented in practice?
   - We do not consider that these are appropriate questions because we have fundamental concerns over the appropriateness of the method.
   - However, we have the following comments on equalisation levies (with particular reference to the Ottawa/OECD's tax framework design concepts):
     - It is critical that any solutions are specifically limited to taxing profits only. A corporate income tax on turnover would pose a serious threat to growth and drastically distort competition. Similar the preceding examples, the risk of double taxation would be large and it would be difficult to create rules that were neutral and easily administrable.
     - Regarding flexibility and sustainability, it is challenging to say with certainty whether a new definition will be more resilient to changes in business models than the existing thresholds, given our comments above about the inherent uncertainty regarding future developments in business as a result of the digitalisation of the economy.
     - Regarding proportionality, effectiveness, and fairness, it is difficult to conceive how turnover based taxes (which hit businesses with different margins in the same way) could be conceived to be fair, and would likely create an uneven playing field.
     - It is incorrect to believe that a tax on turnover would not be passed on to consumers in the same vein as a value-added tax. This represents a prime example of how tax can become a barrier for the growth of the digital economy.

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2 A number of other tax measures have been proposed, announced or introduced by various countries that seek to address the direct tax challenges of highly digitalised business models (e.g. diverted profit taxes, new withholding taxes, turnover taxes).

a. What are the advantages and disadvantages of these approaches? Where possible, please share any direct experience from the implementation (e.g. compliance, impact on business operations) of these approaches.

b. How might some of disadvantages of these approaches be addressed or mitigated through tax policy design?

- The major disadvantages of these approaches are:
  i. That they have not been aligned internationally (i.e. operating outside of double taxation treaties and without regard to differences in other countries' taxation systems), thus increasing the risk of double taxation without credit (and particularly the arbitrary outcomes that can arise as a result) and increasing the compliance burden.
  ii. That their interactions with other taxes (e.g. VAT) has not been considered in detail before implementation.
  iii. The inherent uncertainty that accompanies rules that are divorced from internationally agreed and well defined best practices (particularly where they are introduced quickly rather than as a result of considered consultation).
  iv. The impact that they have had on businesses that were not originally intended to be within scope (e.g. the UK's Diverted Profits Tax has applied even to UK headed businesses, rather than just businesses without a physical presence in the UK).
  v. The disproportionate impact on small, growing, loss making and low margin businesses (particularly with regard to turnover based taxes).
  vi. The considerable risk of distorting competition by creating an uneven playing field for digital and non-digital companies across different sectors.
- We do not see any advantages with the unilateral measures that have been introduced in recent years. However, the disadvantages of any solution would be curtailed somewhat if one solution were agreed internationally for against which credit were available.

c. What are the specific impacts of these unilateral and uncoordinated approaches on the level of certainty and complexity of international taxation?

- Aside from investors' overall assessment of the stability of each country's tax regime[3] (which is influenced by departures from international standards and frequent legislative changes), unilateral and uncoordinated approaches negatively impact certainty and increase complexity of cross border trade and investment for the following reasons:
  - Interaction with tax treaties, and qualification (or lack of qualification) for foreign tax credits.

[3] The OECD's recent work on Tax Certainty found that "the overall tax environment" was in the top three general factors affecting investment and location decisions.

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- Interaction with other laws (both domestic and foreign), including anti-hybrid rules, controlled foreign company rules, VAT/indirect tax rules, and general principles of expense deductibility.
- Novelty (i.e. departure from longstanding and/or internationally agreed guidance and principles, or those which courts have previously ruled).

E. Other Comments

1 Are there any other issues not mentioned above that you would like to see considered by the TFDE as part of its work on taxation and digitalisation?

- We believe the above is a practical starting point, but only a starting point, and, as we have made clear above, we look forward to the opportunity to feed in more extensively (across longer timeframes where more comprehensive thoughts can be collected) as the project continues.

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