Submitted by portal

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RESPONSE TO EUROPEAN COMMISSION SURVEY ON FAIR TAXATION OF THE DIGITAL ECONOMY

Thank you for the opportunity to provide input to your survey on the "fair taxation of the digital economy". We do believe, however, that it would be better to refer to the "digitalising" economy rather than the "digital" or even "digitalised" economy. Although the changes over the past 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, as many more economies, governments and industries go through the process of digitalising. Each will be affected by tax policy changes in this area and it is imperative to recognise that policy decisions made now will impact **all** businesses in the future.

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 (with the EU as a clear leader in seeking consistent implementation of BEPS and BEPS-like measures across the bloc), we need to turn to the challenges of the future. There is an overwhelming need to make sure the changes being wrought by digitalisation promote growth and employment for the entire economy, including through cross-border trade and investment, in line with the broader European digital policy agenda (i.e. the EU's Digital Single Market Strategy). The Digital Single Market Strategy rightly recognises that the key to unlocking future growth and job creation potential lies in the digital transformation of the economy and society. This approach should be endorsed beyond the EU's borders.

Questions of "fairness" are appropriate when designing tax policy, and accordingly we support the European Commission in seeking to ensure that any proposals are fair. But once fair policies are decided they must be implemented in rules that are as clear as possible, accurately embodying the policy decisions made, and taxpayers must be able to rely on them. In this regard, we consider that it is important that policy decisions taken seek to ensure that all businesses are treated equitably. There should, therefore, be a focus on developing a method of determining profits chargeable to tax based on the value created in each country (and comprehensive mechanisms for double taxation relief), so that different businesses are not penalised relative to peers undertaking similar activities. Once legal rules are agreed, businesses must be allowed to operate in compliance with these rules.

We endorse the OECD's taxation principles as laid out in its BEPS Action 1 Report, which build on the Ottawa principles that ensured that growth-suppressing national taxes would not be imposed on the nascent digital sector twenty years ago. Today – thanks to that Ottawa framework – digitalisation is revolutionising economies, business models, and the lives (at work and at home) of billions of citizens – including in the EU. More change is still to come, so any measures implemented must continue to have these principles at their heart.

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We welcome the European Council ECOFIN's conclusions on 'Responding to the challenges of taxation of profits of the digital economy'[1], in particular the following points which we consider should be at the heart of the Commission's work in this area:

- Para 1 notes that the discussion should focus on the taxation of profits.
- Annex I Para 21 encourages close cooperation with the OECD and other international partners in addressing challenges.
- Annex I Paras 5 and 16 recognise the need for rules to be suitable for digital, sharing, and more traditional sectors of the economy. Annex I Para 9 notes that digitalisation has acted as a facilitator and accelerator of cross-border trade and affects the whole economy.
- Annex I Para 6 supports a detailed examination of value creation and profit generation, and confirms that taxes should be paid where value is created.
- Annex I Paras 10 and 14 endorse the existing international tax framework and recognises the need to act within it.
- Annex I Para 17 is clear that options should be explored, but does not endorse their implementation.
- Annex I Para 25 notes the importance of a broader examination of the economic impact of proposals.

With these points in mind, however, we do see significant issues with each of the European Commission's proposed options. 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, and it will disadvantage the EU relative to its competitors. These additional tax costs will create barriers to entry for new businesses and for developing markets. We highlight the OECD's BEPS Action 1 recommendation that any unilateral actions should respect existing treaty obligations. We have included some brief thoughts on the proposals below.

Although the changes over the past twenty years have been dramatic, larger changes are coming, and it is imperative that we do not have a divergence of standards internationally that results in double taxation (or corporate taxation of non-profit bases), harms growth, or inhibits the ability of companies to digitalise. The ground continues to move beneath us and we must therefore look forward, rather than backward, if we wish to create a path that addresses governments' concerns.

Our members have reported a broad range of new taxes and unilateral approaches taken by different countries to address their concerns in this area (e.g. equalisation levy in India, web tax in Italy, Diverted Profits Tax in UK/Australia, and VAT registration changes in Israel/Russia). However, we believe that addressing governments' valid tax base concerns must instead be a deliberative and considered global conversation, in order to avoid unnecessary administrative burden or jeopardising the possibility for agreement on a growth-led global approach.

Although we recognise the concerns and agree that that political pressures demand that these concerns be addressed swiftly, this cannot happen coherently, with due consideration of the

[1] http://www.consilium.europa.eu/media/31933/st15175en17.pdf

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broader economy (and the future economy), in a few weeks or months. Furthermore, it must be a conversation which – unlike BEPS, where the activities of multinationals were perceived to be the "problem" – involves a close partnership between the OECD, the EU, a broad range of national governments, business and other stakeholders to try to discern what the future might look like.

In order for changes to the taxation framework to be coherent and sustainable, we believe that they must be implemented globally. The EU is rightly a strong and important voice in the international discussion being led by the OECD. However, businesses themselves have also been at the forefront of driving digitalisation – and businesses across all sectors are increasingly seeing new ways in which digitalisation can add value for all their stakeholders. At the heart of this conversation is the fundamental question of where value is created. Regardless of whether or not they are profitable, or where they are located, digitalised and digitalising businesses have seen how digitalisation can be harnessed to create value first hand, and they have the best insight as to how and where this happens, why this happens, how this changes over a business lifecycle, and how this itself is evolving all the time. We urge the EU, as an active leader in the OECD's work, to devote significant additional time analysing current and emerging business models to achieve a reasonable consensus with business on the source and location of value creation. A proper conclusion on value creation is a critical prerequisite to proper tax rules fit for purpose for the digitalised economy.

As noted above, at the heart of this conversation – and, obviously, a source of contention between countries – is the fundamental question of how and where value is created. BIAC believes that it will take time to establish what **must** be a multilateral consensus on this issue. BIAC stands ready, therefore, to fully engage in that sustained conversation, and to work intensively, constructively and cooperatively over the next few years to help reach a truly multilateral agreement that sets a new, sustainable pro-growth tax framework that meets the needs of all stakeholders.

Specific comments on proposals

As a general comment, we also request the European Commission review our response[2] (and other responses) to the OECD's recent request for input on the digitalisation of the economy. The OECD, BIAC, and other stakeholders with a range of interests raised significant concerns and a number of important suggestions which we believe will also be helpful to you.

We believe that the EU is within its rights to examine all of these proposals (and others) and encourage the EU to share its findings and conclusions with the OECD to aid the global discussion. However, we do not consider that any are appropriate without a global agreement to ensure coherency, mechanisms for relief against double taxation, and detailed work on the challenges they would face to ensure compliance with the Ottawa framework. We believe that several cannot be considered appropriate under any circumstances.

Turnover based approaches

[2] http://biac.org/wp-content/uploads/2017/10/BIAC-Comments-OECD-RFI-on-Tax-Challenges-of-the-Digitalised-Economy1.pdf

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We are most concerned about the economic damage that taxes on turnover could cause. Such levies target the turnover of digitalised enterprises without a link to either profits or the value creation in the jurisdiction where they are levied. This should not be described as a corporate tax as it has no correlation to net income / profits.

It is not clear either to us what precisely "equalisation taxes" are intended to equalise. Rather, they tax gross turnover (sales). Withholding taxes pose many administrative difficulties, even on domestic transactions, particularly because the obligation can only be imposed on those who have the appropriate knowledge to operate it (consumers, intermediaries, and suppliers would each face challenges in this regard).

Such taxes would necessarily hit all businesses small and large. Low margin and loss-making businesses (such as those investing for growth) would be impacted disproportionately. Typically, equalisation taxes increase the local cost of goods and services. We are concerned also that such taxes may not be legal under EU Law to the extent that it hinders the principle of freedom of establishment.

Even if solely as a backstop to avoidance, turnover taxes would impose an additional administrative burden on each buyer / recipient of digital services because they would have to develop with (or deal with) new systems of collection, reporting, submission, and audit. Both withholding taxes and equalisation levies would lead to double taxation and significantly inhibit the potential to deliver economic growth to the whole economy through digitalisation. The EU's moves in the field of VAT in this area are instructive of the difficulties that would be faced regarding split payments and/or place of consumption registration.

Nexus based approaches

The introduction of a "significant economic presence" threshold would be a major change that would untether the PE concept from physical presence and thus be a significant departure from the existing rules, and make it challenging to apply existing profit attribution rules (which are 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 will pose incredible challenges regarding administration, the allocation of profits, and 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.

It is challenging to say with any 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

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future developments in business as a result of the digitalisation of the economy, this would need to be very carefully thought through. The only way to find that out (and the best way to achieve it) would be a sustained international conversation including the EU, OECD, G20, and other countries – as well as business.

Finally, 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 to disinvest from smaller jurisdictions.

Other proposals

We recognise the European Commission's comprehensiveness in considering options that are not currently being debated in the OECD TFDE. However, we cannot endorse them as standalone EU solutions. We do not believe any of them address the concerns raised regarding the allocation of profits to the EU relative to non-EU countries (although they could, if the concerns highlighted below are overcome, address concerns regarding intra-EU allocation of taxing rights).

In order to avoid arbitrary lines (which encourage avoidance and distort investment decisions), such systems would need to be introduced across all industries and geographies. Accordingly, the compliance burden and impact on business, trade, and investment would be significant, particularly if different systems are implemented in different regions.

Indirect tax issues

While it is not the place of BIAC to comment on interpretation of EU law, we do share many of the concerns related to VAT expressed by other commentators in relation to multiple turnover taxes within the EU.

Additionally, one highly debated topic around the world right now is the cross-border supply of goods facilitated by the internet, including the interaction with VAT and customs duty relief (and customs processes generally) as well as the role of online platforms and intermediaries in the VAT/GST collection process. Some governments outside the EU (eg, Australia) have already taken steps to implement measures in this area, while the European Council has recently agreed to adopt new rules to extend the Mini One Stop Shop (MOSS) to the B2C sale of goods, to remove low value consignment relief for goods imported from outside the EU with a value of less than €22, and to make online platforms liable for collecting VAT on the B2C sale of goods they facilitate.

These EU measures still need to be worked out in detail and agreed in an Implementing Regulation before 1 January 2020 to ensure application of the rules from 2021. However, the commercial reality is that there is a wide variety of new and constantly evolving business models with different parties involved in the 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 (eg, as a tax collector or information provider for the tax authorities) and who cannot. Above all, it will be 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. The complexity inherent in this area should not be underestimated, and it will be critical for the EU Commission to engage widely with business when working on an Implementing Regulation

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(particularly given that the adopted rules have been brought into the Council negotiations by Member States with no prior consultation with business at an EU level), in order to take measured and informed decisions to ensure legislation that is both simple and effective. These matters are also being discussed in the OECD VAT/GST TAG process at the moment, thus it would make sense to reconcile with the OECD in order to ensure a consistent and aligned approach both at an EU and global level.

Finally, whilst various options unrelated to VAT are suggested as possible solutions to address the broader corporate tax challenges raised by the digital economy, some of these options could have an impact on VAT. For example, any changes to the current permanent establishment concept may have an effect on the application of the simplified VAT registration procedure (MOSS). Such changes might also influence collection models such as the application of the reverse charge mechanism. Therefore when considering these options from a direct tax perspective, adequate time should be dedicated to fully understanding the potential VAT consequences.

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