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16 May 2018

European Commission Proposals for Directives regarding fair taxation of the digital economy ("Digital Tax Package")

Introductory Comments

PricewaterhouseCoopers International Limited on behalf of its network of member firms (PwC) welcomes the opportunity to respond to the European Commission ("the Commission") with respect to its requests for feedback on its proposed Digital Tax Package consisting of:

- *Proposal for a COUNCIL DIRECTIVE laying down rules relating to the corporate taxation of a significant digital presence* (and Annexes, and *Commission Recommendation relating to the corporate taxation of a significant digital presence,* together "the comprehensive proposals");
- *Proposal for a COUNCIL DIRECTIVE on the common system of a digital services tax on revenues resulting from the provision of certain digital services* ("the interim proposal").

While we acknowledge that the Commission has requested feedback individually on each of the two proposed Directives, we believe that they cannot (and should not) be viewed in isolation of each other, or the Recommendation to Member States which we consider is inextricably linked to the comprehensive proposals. We have therefore prepared a consolidated response for submission to both of the Commission's requests for feedback.

The broader context

Digitalisation of businesses, tax administrations and economies is a global phenomenon and in our view, solutions need to be developed, endorsed and implemented globally. PwC believes that the digital economy is not a sector that can or should be identified clearly and taxed separately; digitalisation is an accelerator for growth, and taxation should not inhibit that more than it does with traditional business.

PwC appreciates the desire of the Commission for a long term comprehensive solution. In our view, the proposal should serve to demonstrate the EU's leadership role in the further work of the OECD Inclusive Framework ("IF") in the coming year, but should not be pursued and implemented on a regional basis.

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Where the proposal of the European Commission for Digital Services Tax (DST) intends to tax gross revenues, we are particularly concerned about the potential for double or multiple taxation, the impact on investment and the impact on economic growth. PwC sees a risk that a DST is not compliant with international obligations, e.g. scope and non-discrimination articles under double tax treaties (and investment and trade agreements), EU considerations (state aid), and World Trade Organisation obligations.

These risks are exacerbated by the possibility that even where applied via a Directive, the rules as legislated in different Member States will not be fully aligned, and there is a possibility that States will retain such a tax, even after global consensus has been reached. The same risks would arise if EU Member States or other countries were to introduce wholly unilateral measures, which we appreciate the Commission is seeking to avoid. However, we do not believe that action at the EU level would eliminate these risks, because it would still introduce a difference between the EU and non-EU international tax frameworks (and, as noted above, could result in double taxation).

PwC welcomes the analysis of the OECD IF in its Interim report. In order to design global, sustainable, long term solutions, a deep understanding of the various business models, how value is created, and the role of data and users is essential. We stipulate that aligning taxing rights with value creation is one of the core principles underpinning the BEPS-project. Time is rightly being taken by this group of 114 countries to consider the perceived problems, the real challenges, their impact, and potential solutions that could attract multilateral consensus, within a challenging but realistic timeframe.

In pointing out all the potential pitfalls, the design recommendations from some countries included within the OECD Report may go some way towards discouraging countries from taking unilateral action.

In previous communications (including our letter dated 3 January in response to the Commission's survey on the *Fair Taxation of the Digital Economy*), we welcomed the European Council ECOFIN's conclusions on 'Responding to the challenges of taxation of profits of the digital economy' that support a detailed examination of value creation and profit generation, confirm that taxes should be paid where value is created (Annex I paragraph 6), and recognise the importance of close international cooperation (Annex I paragraph 21) and the broader economic impact of any solutions (Annex I paragraph 25). We continue to endorse these objectives.

Consideration should be given to the potential impacts of the proposals, in particular, on trade within and beyond the EU. Member States are likely to be affected in different ways and the treatment of transactions, considered either at an EU level with third countries (where EU trade agreements have been reached or are being negotiated) or between particular Member States and third countries (tax agreements reached or being negotiated), may be put at risk by departing from an internationally recognised and negotiated framework, as well as effectively placing restrictions on treaty wording that Member States can negotiate.

The views might be sought of counterparties to Free Trade/ Global agreements between the EU and third countries or more generally in connection with World Trade Organisation rules, to limit the potential trade disputes or retaliation which might be invited by the EU acting without publicly addressing such concerns.

Digitalisation of the economy

Global profits of multinational companies are generated through many activities by many legal entities in many countries. Synergy-related profits are also realised. Allocating profits, based on functions, assets, and risks, in the various countries, has become an extremely complicated matter.

Digitalisation (both through a host of new products/services, and through impact on more traditional functions) is further altering value chains within multinational companies and leads to questions about where value is generated. How these new value chains will run through different legal entities and countries will change the tax analysis. In short, business models and value chains are changing fundamentally and value creation is becoming increasingly independent of (physical) activities and physical presence in a market. We do not believe that enough time and consultation has been devoted in identifying solutions that appropriately address concerns in ways that will be effective in the long term, aligned to the objectives of the single market, and in the interests of EU citizens by driving innovation, growth, and investment. In particular this applies to identifying the way in which different factors (including, but not limited to users) create value for digital businesses, and how this should be attributed consistently and fairly to the proposed new permanent establishments ("PEs").

Additionally, other countries involved in the IF project have asserted that they consider that broader changes are needed to the international tax framework to address the challenges of globalisation and digitalisation. These may include rewarding market jurisdictions more for the value that these countries assert are provided by the existence of the market. The Commission should consider how the concepts of user created value align with these broader concerns (and where they do not) as it seeks to develop a solution that could be agreed globally.

Recommendations

Our previous submissions recommended a framework (from a business and tax perspective) for further dialogue, while stressing the need to avoid unilateral and reflex actions, some of which were described in the questionnaire and have been called for by certain countries. We again endorse this framework for the Commission's consideration.

Policymakers can and should view digitalisation as an overall accelerator for growth, with taxation as a potential and significant restraint if it is not done appropriately – turnover taxes would inhibit growth with significant potential for double taxation. Countries will benefit from a smaller share of a bigger pot of tax revenues (not to mention the additional non-financial benefits to consumers and societies that increased digitalisation can bring).

PwC remains of the opinion that:

- the digital economy is not a sector that can or should be identified clearly and taxed separately;
- there is a need to understand how value is created in digitalised business models and whether this is different from traditional businesses;
- unilateral actions by individual countries (or the EU as a group, separately from the rest of the IF), will distort behaviour and have a negative impact on growth (discouraging investment in the EU);

- time should be taken to consider the perceived problems, the real challenges, their impact, and potential solutions that could attract multilateral consensus; and
- any temporary measure should only be enacted when it provides for a sunset clause.

All the concerns expressed above have not prevented some countries from taking unilateral measures already. Their political and revenue needs are, in some cases, pressing. Although we understand these needs, we urge policymakers and politicians to direct their efforts towards reaching a global solution in the OECD IF.

Further engagement
Before making fundamental changes to the tax system, engagement from a wide range of taxpayers and other stakeholders would enable a thorough investigation of the ways that value is created by digitalisation and how that can be encouraged through pro-growth tax policies. In line with the ECOFIN recommendations, part of this must of course include an identification of where value is created so that it can be efficiently taxed - but this must have growth at its heart. PwC would welcome further opportunities to engage on this issue.

Additionally, we believe there are benefits to addressing broader economic challenges that our economies face simultaneously, as tax will be impacted by them (and vice versa). Globalisation is the most apparent, but environmental unsustainability, demographic change, inequality and political uncertainty may all be relevant to thoroughly address digital transformation. As an employer we believe that even the existing model of higher education has yet to adapt to shifts in the factors that underpin the global economy. We would be willing to engage with the Commission to see how our experiences and expertise might contribute to the Commission's broader agenda.

Next steps
The Appendix to this response outlines our specific concerns with the proposals of the Digital Tax Package. We wish to continue to positively engage in this dialogue, and we hope that our views will be of use to the Commission in considering further implementation of global solutions that address its objectives.

For any clarification on this response, please contact the undersigned or any of the individuals below. We look forward to discussing any questions you have on the points we raise above. We would welcome the opportunity to contribute to the discussion.

Yours faithfully,

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Appendix

1. *International engagement, timing, and EU competency*

We welcome the European Commission's contribution to multilateral conversation that continues at the OECD regarding the tax implications of digitalisation. In seeking to identify and explain its concerns, and working on ideas to address them, the Commission is playing a valuable role in engaging stakeholders and moving this international discussion forward.

However, to the extent that a solution is introduced at an EU level ahead of an international consensus, we are concerned at the impact this could have on the EU as an investment and innovation hub, as well as on the international conversation itself.

Potential impact on the international tax environment and negotiations

The G20 and the OECD Inclusive Framework (IF) have heard the concerns raised by the European Commission and several EU Member States, and the work of the OECD has accelerated accordingly (the OECD's interim report published 16 March 2018 ("the 2018 OECD report")). We continue to endorse a global discussion and global solutions agreed as part of this project by the 114 countries of the IF. We are concerned at the impact that unilateral EU action could have on this international conversation and negotiation.

At a time when many non-EU countries are also implementing (or considering implementing) measures outside of the internationally agreed tax framework, EU proposals outside of that framework (even if not unanimously agreed) could be taken to endorse countries' rights to introduce unilateral measures rather than constructively engaging in sustained and purposeful negotiations. While we understand that many within the EU Member States and institutions believe that the EU has a responsibility to be a leader in the development and implementation of tax and transparency initiatives, this is best demonstrated through leading a purposeful and sustained dialogue at the OECD. If, despite the risks, the EU chooses to introduce targeted measures, we envisage that such unilateral action from the EU may be contrary to trade agreements (see further below) and could also trigger retaliatory action that impacts EU businesses and citizens. In fact, we believe that the expected progression of the Digital Tax Package plainly invites such retaliatory measures in that (bearing in mind the accumulated revenues of EU vs. non-EU businesses in scope) the double taxation will arise mainly for businesses that are headed outside of the EU. It also does so in ways that in practice would often not give an EU taxation result consistent with the group's "presence" in the EU[1].

We do not believe it is sufficient or appropriate for the targeted proposals to cease only where another country has agreed to cede its tax base through treaty revisions because this would

[1] For example, a non-EU business with global turnover of €760m and taxable EU revenues of €60m would be in scope and subject to €1.8m of tax, whereas an EU business with global turnover of €740m and taxable EU revenues of €740m would not be in scope, and subject to DST of €nil despite having significantly greater "presence" in the EU.

heighten the risk of non-EU headed businesses being subjected to higher levels of double taxation to the extent that their treaties could not be changed simultaneously via an EU mechanism (and note that while such a provision has been discussed as part of the Digital Tax Package, it does not appear to have been included in the text of either of the draft Directives).

Additionally, while solutions agreed within the treaty framework could rely on the dispute resolution mechanisms agreed under the treaty, the same is not true for other solutions (such as turnover taxes). Especially given the complexity of ascertaining where users are located and how this interacts with taxing rights, we believe that a comprehensive dispute resolution mechanism will need to be included in any non-treaty based solutions to ensure that multiple implementing countries do not seek to tax the same turnover. Double taxation is harmful, and the same income being taxed more than twice is even more so.

Potential impact on the outcomes of an international solution

Even without the potentially heightened tension with trading partners (and particularly with regard to transatlantic tax relations), implementing an EU only legislative approach at the same time as trying to agree an international solution could result in multiple different standards being implemented.

Aside from the benefits of allocating scarce Commission and Member State resources toward a solution that is globally (rather than regionally) recognised, any differences between the comprehensive proposals and a globally agreed solution would add additional complexity and cost to businesses and tax administrations in applying them. The worst outcome would clearly be a long term scenario where intra-EU thresholds and attribution rules differ to the rest of the world, but the alternative (introducing intra-EU rules that are soon after replaced with global rules) would also cause considerable uncertainty, complexity, and compliance cost.

> It is instructive to look at the way indirect tax practitioners and policy makers have collaborated on addressing the VAT/GST challenges of the digital economy over the course of a number of years. Through its Working Party 9 on Consumption Taxes and the Working Party's Technical Advisory Group (comprising government, academic and business representatives), the Committee on Fiscal Affairs has developed a framework for the consistent application of VAT rules at a global level in relation to services and intangibles, including digital services - the OECD International VAT/GST Guidelines ('the Guidelines'). Over 100 countries, jurisdictions and international organisations have endorsed the Guidelines, which serve as a reference point for the growing number of countries around the world designing legislation to address the VAT/GST challenges of the digital economy. For example, to date over 50 jurisdictions have adopted rules for the VAT treatment of B2C supplies of services and intangibles by foreign suppliers in accordance with the Guidelines. Based on this successful approach we would recommend using similar working processes in this context - the OECD coordinating the active involvement of all

stakeholders to solve the complex international tax issues at stake in a way that safeguards tax revenue whilst fostering global growth.

The challenge and complexity cannot be overstated. For example, one of the most difficult areas for taxpayers to comply is the existing PE attribution rules, where different countries apply the 2008 Authorised OECD Approach ("AOA"), 2010 AOA, or non-AOA approaches. An opportunity exists to broaden the conversation and potentially eliminate this complexity globally – rather than compound it.

Potential impact on Member States

We are concerned primarily with the interaction of the interim and comprehensive proposals on the ability of Member States to exercise their sovereign rights to negotiate tax treaties. The Digital Tax Package implies (but it is not included in either of the draft directives) that where a third country amends its treaties with a Member State to be in line with the comprehensive proposals, then the Digital Services Tax ("DST") previously levied on that country's taxpayers would no longer be levied. However, tax treaties require significant negotiation to agree, and EU Member States (and the third countries with whom they negotiate) may have varying objectives from and degrees of power in such negotiations.

In addition, we are concerned that for some Member States and for some taxpayers, the DST charge could be higher than the corporate tax that they would receive under the comprehensive proposals. This would disincentivise those Member States from agreeing to the comprehensive proposals .

While there is insufficient detail included in the proposal to draw firm conclusions, it is noted that deductions are likely to be granted on a Member State by Member State basis (presumably on the basis of the deductibility of ordinary business expenses). Under such a mechanism, a taxpayer would be incentivised to locate real investment where they expect to have the highest DST charge, in order to be able to deduct a portion of the costs. This could *de facto* encourage additional investment in the larger Member States, and discourage investment in smaller Member States (both from outside and within the EU). The calculation may of course also depend on tax rates.

In order to avoid double taxation, tax treaties normally provide for an exemption or a credit mechanism. Deduction of foreign taxes is often seen as the mechanism of last resort. Generally, credit mechanisms rather than deductions are favoured by businesses because they are less likely to result in double taxation. Further, we believe that a credit system (rather than a deduction system) in proportion to the taxpayer's liability in each Member State would be more aligned with the objectives of the single market and the proposals (assuming that this could be implemented legally), although we remain concerned as to whether both credit and deduction systems could be deemed to constitute *de facto* discrimination.

Potential impact on EU investment, businesses, citizens and innovation

Many of the businesses within scope are still growing and reviews of their financial statements suggest that some have low average margins (below the 3% rate of the proposed DST). It is not a realistic choice for them to stop investing for growth (in contrast to public comments made by Commissioner Moscovici in April 2018). Rather, as their costs of doing business increase, these businesses are likely to either increase costs to EU users and customers, or stop providing all of their services to EU users and customers. The benefits – to citizens, governments, large businesses, SMEs, and other stakeholders – that digital services provide has been a catalyst for significant growth outside of the Information and Communication Technology (ICT) sector in recent decades, and many such stakeholders rely on the services that in scope businesses offer. We believe that making such services more expensive and difficult for EU SMEs is not in line with the EUs broader Digital Strategy and could have significant implications on their success.

Additionally. We have observed several businesses based in the EU that are not within scope only because their global revenues do not exceed €750m. Typically, these businesses have low margins, are seeking to scale up through programs of continued investments of their profits, and hope to become global players in their fields. The €750m global turnover is a cliff-edge that disincentivises these businesses from growing and competing with larger international competitors. We do not believe this is appropriate, nor in line with the EU's Digital Strategy (or even the objectives of the Commission's Digital Tax Package).

These concerns could be addressed by undertaking an impact assessment that recognises the potential negative implications of the proposals on EU investment (and other interaction between EU and non-EU taxpayers), as well as the potential impact on individual EU Member States of each of the proposed Directives.

Timing

As noted above, we endorse the OECD IF continuation of discussions at the OECD as the primary forum for European Member States to discuss proposed changes, and that this discussion has already been accelerated. Aside from our concerns above regarding the potential impact on negotiations, we have several more general points as to why we believe that the OECD's proposed timeframe (i.e. preparing recommendations, rather than implementation, in 2020) is more likely to produce a coherent and sustainable outcome:

- US Tax Reform has only recently been enacted, and will have a significant impact on the tax profiles of all US MNEs. Many of these businesses are within scope of the proposals, and the Commission's communications suggest that perceived low tax rates accelerate the need for action (although we note that the authors of the studies used by the Commission have suggested that the statistics are not relevant for comparing the effective tax rates of "digital" and "traditional" business models).
- The tax reform in the US may precipitate a change in direction of the global debate about source and destination based revenue taxation, and the application of the arm's-length principle to which the Commission should be ready to respond.

- Similarly, the BEPS Project Recommendations are still being enacted (including in the EU, where the reverse hybrid elements of ATAD will not be enacted until 2022 and some interest limitation rules will not become applicable until 2024), so it is a challenging time to identify the impact of new proposals on tax bases and companies' tax contributions.
- In addition, the digital revolution continues apace, and is unlikely to slow down soon. While this is not an excuse for inaction, it should be considered as a factor in designing proposals that will be robust in the longer term (i.e. a more detailed review of the potential tax challenges of the future should be undertaken alongside the current discussion).

2. *The interim proposals*

As detailed in our response to the OECD request for input in 2017 and the Commission's consultation on fair taxation of the digital economy on 3 January 2018, we continue to believe that turnover based approaches are an inappropriate solution that could cause significant harm to the EU.

Given the focus of the interim proposals (ring-fencing specific business models) compared with the comprehensive proposals (broader proposal with carve-outs for specific industries), we do not believe that it can be seen as a stepping stone that somewhat replicates the impact of the comprehensive solution. The two appear to be unrelated.

In particular, while we welcome the fact that intra-group transactions are not included in the scope, we are concerned that many of the specific points we raised in our previous submission were not taken into account. In particular:

- The straight 3% levy does not take into account the differing margins of very different business models, nor the actual value creation of the users (to the extent that the comprehensive solution would deem there to be such value creation).
- There is no carve-out for organisations not subject to corporate taxes (e.g. charities in some Member States).
- Questions of EU law have not been addressed and, in particular, there is no examination of the overall tax burdens of residents and non-residents (which is particularly acute to the extent that EU Member States would under the draft Recommendation have to change intra-EU treaties swiftly).

Concept of users creating a taxable nexus

The concept of "users" using services (which may or may not ultimately attract revenue, directly or indirectly) as a basis for taxation rights is troubling. It is not tailored enough to identify the actual value created by users (or groups of users) and because it is detached from the existing international tax framework (which looks to value created by the business based on its significant people functions operating in each country) it will result in double taxation.

In addition, because this concept is so different to the profit attribution method in the comprehensive proposals, it is very unclear whether individual businesses would have to pay more or less tax under the interim solution compared to the comprehensive solution. There would likely be some businesses that would pay tax under each while others would not, which raises further questions regarding the appropriateness of the targeting and of the equitability of the measures.

As a related point (which is touched on above in our general comments), we do not believe it is correct to assume that all interaction with users leads to the same levels of net revenues for each business, nor that there is necessarily a correlation between this interaction and the net profits of a business. In reality, collecting user data is expensive, for reasons including (but not limited to):

- the need to develop and maintain a compelling platform or service offering that attracts enough users to generate scale and realise network effects
- storage, privacy and security systems, and
- regulatory expenses relating to GDPR and other requirements.

As a result, many businesses will make low profits (or no profits, or losses) from collecting user data, particularly if they are not the leader in their industry, or are monetising the data in different ways to their competitors (rather than directly competing where they may have a comparative disadvantage). The OECD 2018 report discusses network effects further.

Business compliance

The challenge of complying with the interim proposals should not be overlooked. Many businesses do not collect the data needed to ascertain their "EU taxable profits". For example, while some businesses will track how many "active users" (itself an inconsistent term in application) they have in various geographies, many will not (and increasingly this is becoming a less important metric where businesses offer global services). Even those that do track the location of users may not track the number of times that adverts are shown to them on a country by country basis (and in many cases will not receive revenues based on the number of times an advert is shown to a user, rather by how many times users click on it, which also may not be tracked on a country by country basis).

An interim solution that is not intended to apply in the long term should not warrant expensive new systems to be created in order to comply. Significant systems changes will be required in order for businesses to comply with the proposals and for the tax to be collected. In many cases businesses may incur costs to reach a conclusion that there are insufficient "EU taxable profits" for the €50m threshold to be breached. A more appropriate threshold that does not require systems changes would provide some relief in this regard.

Similarly, we question how tax administrations will police the threshold and the calculations. In order to ascertain whether the threshold has been breached they would need to look at a business' entire EU business, which may be outside the scope of their competence and it would be difficult for individual Member States to devote appropriate resources to identifying this individually.

The various ways in which users' activities could bring a business within the charge to the tax in each Member State could also result in digital services covering the same activities but in different States being recognised in each of them with double taxation arising within the EU (for example where the user logs in to an interface in multiple Member States). Much greater clarity in taxing rights, and comprehensive dispute resolution mechanisms within the proposal would be useful in addressing this challenge.

Discrimination

While we understand that around 150 businesses will be in scope, around 50 of which will be in the EU, we are concerned that around 75 are estimated by the Commission to be in the US with the balance in other third countries. This seems to be predominantly because of the global turnover threshold for in scope businesses, regardless of their actual presence in the EU relative to their competitors. We are concerned that this could be deemed *de facto* discriminatory and invite challenges or retaliatory measures. This risk would be heightened if EU Member States were to swiftly update their intra-EU bilateral treaties to introduce the comprehensive proposals while others would likely be reluctant to do so (at which point all of the in scope businesses would be non-EU businesses, with 75% being US based).

On the basis of the perceived impact, Member States may raise challenges on behalf of businesses located in those States, either under EU principles or on the basis of broader agreements, bilaterally or multilaterally.

EU principles of the proportionality of a 3% tax on low margin businesses, could be extended under The Charter of Fundamental Rights of the EU, Article 20 ("Everyone is equal before the law") and Article 21(2) ("Within the scope of application of the Treaty establishing the European Community and of the Treaty on European Union, and without prejudice to the special provisions of those Treaties, any discrimination on grounds of nationality shall be prohibited"). The example discussed in a footnote earlier showed how two businesses with marginally different revenue splits may be treated differently under the proposals. This was shown to be the case, even though the business outside the scope had a greater EU footprint. It suggests the €750m global revenue threshold may not have been chosen appropriately, notwithstanding the overall aims of excluding start-ups, SMEs and others needing protection in this instance. Effectively replacing a direct tax comprehensive solution in the short term with a temporary indirect tax proxy adds to the complexity of this issue, particularly if one were to consider the effective tax rate burden as some businesses become subject to one or the other and some are subject to both.

Measures taken unilaterally by Member States could lead to State aid concerns.

The Commission might discuss the proposals with counterparts to EU Free Trade/ Global agreements reached with third countries like South Korea, partially introduced with Canada or nearing finalisation with Japan to determine any likely response.

Retaliatory measures introduced by any country in relation to measures introduced in an EU Member State (unilaterally, EU-wide or under an enhance cooperation framework) are likely to harm that State's trade position.

We are concerned that the proposed interim digital services tax may not be compatible with WTO law, particularly the EU's obligations under the *General Agreement on Trade in Services (GATS),* and similar EU obligations found in its free trade agreements. As the proposal is a measure "affecting trade in services", in the form of an indirect tax on revenues, it is covered by the GATS.

We have a number of questions regarding the WTO-consistency of the tax, for example:

- Could the operation of the tax, in the way that it is currently designed, result in less favourable treatment to the services and service suppliers of WTO Members than is afforded to "like" services and service suppliers of other WTO Members contrary to the EU's most-favoured nation obligation (GATS Article II)? (Recalling that "likeness" should depend on the attributes of the product/service/supplier rather than the means of delivery, e.g. electronic versus other means.)
- Could the design, architecture and structure of the proposed digital services tax be inconsistent with the EU's national treatment obligation (GATS Article XVII, which extends to *all* measures affecting the supply of services) in sectors where the EU has undertaken specific commitments? That is, could the proposed interim measure result in less favourable treatment to other WTO Members' services and service suppliers than would be afforded to the EU's own services and service suppliers?

The preference for measures based on international standards is highlighted in miscellaneous WTO treaty provisions. Our view is that the WTO-compatibility of this proposed EU measure should be considered in light of the EU's obligations under WTO law and also work that is ongoing at the WTO, e.g. in the context of its e-commerce program. The EU is a proponent on the importance of a rules-based trading system and the role of services in the global economy, illustrated not only by the EU's current participation in WTO and FTA rules on services trade but also its role in the negotiation of the plurilateral *Trade in Services Agreement*.

Assessment against the design considerations included in the OECD 2018 report

The 2018 OECD report identifies a number of design considerations that we believe should be addressed before interim measures are introduced[2].

- Impact on investment, innovation, and growth (and impact on welfare)

[2] Chapter 6 of the OECD 2018 Interim Report on Tax Challenges Arising from Digitalisation notes that "Countries in favour of the introduction of interim measures have set out guidance on the design considerations that need to be taken into account when considering the introduction of such measures." As these design considerations were outlined in the report by a group of countries who themselves saw merit in introducing unilateral measures (including, presumably, some EU Member States), the Commission may struggle to reach agreement in the Council if it does not heed such considerations.

- Common tax thresholds and methods of profit attribution have driven increases in investment, innovation, growth, jobs and welfare.
- It is hard to see how a departure from the international norms would not have a negative impact on investment into the EU and the provision (and cost) of services to EU businesses and citizens.
- However, we believe that this negative impact could be lessened by appropriately targeting the proposals at abusive arrangements.

- Potential economic incidence of taxation on consumers and business
  - Even if simultaneously implemented with the comprehensive solution, as currently proposed, there would clearly be a change in the allocation of taxing rights between EU Member States, because the location of value generating activities (and corresponding corporate tax base under the existing system) is not aligned with revenues. This does not appear to have been addressed in detail in the Commission's Impact Assessment.
  - If the long term solution were not implemented simultaneously, this would result in the highest increase in tax on services provided to EU citizens and businesses (by any company, whether in or outside of the EU). The deduction mechanism would not be sufficient to offset these costs even if it were amended to ensure that 100% of DST is deductible (as it appears currently that sufficient taxable profits in each Member State would be required for the tax to be deducted against).
  - If the long term solution were implemented across the EU simultaneously, this would result in a significant change of tax base allocation within the EU, and could be construed as discriminatory because DST would then impact only non-EU companies. Additionally, it would still result in a higher overall level of tax than is currently paid (to the extent it is passed on increasing the costs on consumers and EU businesses for digital services) because there is no credit mechanism to eliminate double taxation.
- Possible over-taxation
  - Without effective credit mechanisms in place, there will be businesses already paying taxes (either within or outside of the EU) who would be subject to double taxation (paying both traditional corporate tax and DST).
  - The evidence shows that "digital" businesses do not pay materially lower tax rates than other businesses. Even if there were some businesses who were paying significantly lower levels of tax than the EU considers to be a "fair" rate of tax, the DST is not targeted enough to identify such companies. Accordingly the taxpayers who are already paying high rates of tax may be hit hardest by the DST.
  - We do not believe that a "deduction" mechanism is sufficient to relieve this issue. Deductions are worth only a fraction of credits (except for loss making businesses) in economic terms. Additionally, it is unclear how the deduction mechanism would work in practice (see below).
  - Many businesses currently generate a lower margin than 3%. To the extent that DST pushes such businesses from low profits into a loss making position, we believe this is clear evidence that such businesses would suffer from over-taxation (or be forced to try to charge higher prices to customers).

    - We recommend that the measures are more tightly targeted at identified abusive arrangements that achieve artificially low rates of tax only.
- Possible difficulties in implementing as only interim measures
    - As noted above, we are concerned that the measures would not currently qualify as "interim" because they would presumably be required until every EU Member State has signed updated treaties with every other country in the world. We do not believe this is a realistic objective given the time commitment of negotiating such treaties and the potential resistance of other countries from moving away from the global consensus. It is also uncertain whether Member States may in some cases withdraw domestic legislation introduced to comply with the Directive.
    - We would therefore prefer sunset clauses to be included, or, if that is not possible, a rolling review period of one or two years after which the Commission could analyse the impact and Member States would have to positively vote to keep the measures in force.
- Compliance and administration costs
    - The compliance and administration costs of the tax would be significant; many businesses do not track the metrics that would be required to calculate the taxes payable (e.g. user location).
    - Additionally, businesses with over €750m in global revenues would need to carry out significant calculations (and invest in systems to gather the required information) even if they were ultimately not subject to the tax.
    - We endorse the proposals for businesses to be able to pay the taxes due to one Member State, for distribution among the other 27 Member States.

Other technical concerns

We have identified several other technical issues that should be addressed as the interim proposals are discussed further:

- The "transmission" of data (rather than, for example, the sale of data) is a very low threshold. While intra-group revenues are excluded from the general scope, the external revenues that arise subsequent to (and as a result of) an intra-group data transfer could be taxed. Furthermore, those revenues may not be in scope if the data were used to generate revenues without such transmission.
- For the purposes of calculating DST, the location of users must be known. IP addresses will generally be available, but can be obscured by users. Other methods of geolocation will ***always*** therefore be more accurate than IP addresses (unless deliberately falsified by users). However, they are much less frequently available to service providers. The wording that other methods should always be used "if more accurate" therefore places an unnecessary burden on taxpayers that it will simply not be possible to comply with in many cases.
- For the purposes of calculating advertising revenue, an advertisement being shown to a user is generally not a good proxy for the revenues generated from that user. Many businesses collect advertising revenues only when an advert is actually clicked on by a user.

- The dates for payment of DST may be sooner (or later) than the corporate tax deadlines in any Member State. Even to the extent that the tax is deductible, this may cause cash-flow concerns. Additionally, even if it were possible to identify the total amount of DST payable in the deadlines suggested, the corporation tax due in each Member State may not be known at that time.
- While it is included in the preamble that DST should be deductible against corporate taxes, there does not appear to be a comprehensive mechanism included in the draft directive text to ensure this is the case. It appears to rely on the general business principle of the deductibility of 'proper' business expenses in the Member State of residence (or possibly the location of a PE), although in some Member States it remains unclear therefore how this would work in practice.
- The exclusion of certain activities (supply of digital content, communication or payment services) only where provision of that service is the sole or main purpose of the interface could discourage businesses from developing such services in-house (instead relying on third party providers who provide solely or mainly those services). This will have a negative impact on competition, innovation and user experiences.

3. The comprehensive proposals

We have contributed extensively to the public debate on the tax challenges of digitalisation, both through the OECD's consultations throughout and since the BEPS Project, and in our response to the Commission's survey on 3 January 2018. All of these responses are publicly available. We have provided significant detail on business models, data, and the contribution of users, as well as our observations on the challenges to be addressed and our proposals for a framework through which they should be addressed.

We do not believe that the comprehensive proposals resolve the issues that Member States and the Commission observe regarding the tax challenges of digitalisation. The low threshold for significant digital presence would result in a significant increase in the number of PEs (or virtual economic presences) that would need to be recognised in EU Member States. The areas of the proposals that seek to attribute profits to these new PEs are also severely underdeveloped particularly in that they do not resolve many of the prevailing questions that the Commission seeks to solve regarding the value of the contributions of data and users to businesses.

Current profit attribution rules look to the value generated by significant people functions ("SPFs") within a country. It is not sufficient to assert that a profit split method should be applied that takes into account the value of the contributions of users without significantly more detail on how users should be deemed to contribute to businesses and how downside risk could be allocated to the country in absence of SPFs that control the risks (or, instead, recognition that any return must be "routine"), alongside a range of other ways in which such business models generate value.

We believe that further work is needed to provide detailed and comprehensive ideas on how user contribution should be valued. Without considerable additional thought and agreement on this principle, the revised threshold could result in double taxation and double non-

taxation as different companies, Member States and third countries struggle to interpret the rules.

We are particularly concerned at the perception that the EU's trading partners could take from this proposal. While the interim proposals put forward are said to be necessary because the global conversation has not progressed quickly enough, the lack of detail makes it difficult for trading partners to understand precisely what the EU's position is, and in contrast the significant detail regarding the mechanics and chargeability of the interim solution could lead some to believe that the Commission's priority is to introduce a digital levy rather than play a leading role in the discussion on long term global solutions.

As well as these overarching concerns, we have outlined below a number of areas where we believe the comprehensive proposal could be specifically improved.

Threshold

We are concerned that the threshold is too low when compared to traditional PEs. Additionally, the three factors included which could be breached in order for a PE to be asserted may be triggered at very different scales of presence in a Member State depending on the business model.

For example, a business collecting €10 from each of its users per year would breach the 100,000 users threshold at a turnover of €1m, which is far below the €7m threshold. Similarly, where only 3,000 business contracts are required, this could feasibly be reached with a turnover of only €300,000 if the contracts were for only €100 each. Digitalisation has allowed businesses to engage with customers and users to provide services at a much lower cost, and in turn seek to engage customers and users for more flexible, low cost service provision (e.g. subscriptions to digital content, news reports, etc) than was previously the case.

Finally, as a practical matter, we are concerned that the threshold is set so low (with regards to users and contracts concluded in particular) that it may undermine the existing PE thresholds. The existing thresholds require degrees of permanence and activity volume within the market to be established (e.g. physical presence, and the implication of contracts being "routinely" concluded). The proposed threshold could rather be triggered by a low gross amount of revenues from a market, or a low number of contracts concluded (rather than looking at the actual activities undertaken by the business in the country to secure those contracts and revenues). This may therefore be seen by some tax authorities as an easier way of establishing a PE (even for more "traditional" businesses, many of whom will have digital activities of some description) than any of the existing thresholds, so may become the default threshold and undermine the existing thresholds.

Transfer pricing and double taxation

In addition to the general comment that different interpretations of broad guidance would lead to double taxation between the two contracting parties to a treaty, double or multiple taxation will also be likely to occur between non-EU countries where one has renegotiated its treaties in line with the comprehensive proposals and the other has retained the prevailing international attribution guidelines. For example, a non-EU company located in a country that has amended its treaties with the EU Member States (but not with non-EU Member States) could have a PE within the EU, and another outside the EU, and have to allocate some of the same profits to each because of the different attribution rules in force.

A fundamental principle of transfer pricing for OECD is that the most appropriate method is always chosen with regards to the facts and circumstances. We therefore do not believe that a profit split method should be the default method (and even if it is, it should remain consistent with international principles – the OECD Guidance in this area is expected later in 2018).

Moreover, the concept of valuing data or users' contributions as part of a profit splitting calculation is difficult to reconcile with existing transfer pricing principles, and we do not believe that it is appropriate to consider factors of collection, sale, and service provision alongside these existing principles under a profit split method.

However, if the EU decides to introduce such principles, then significantly more detail is required. As well as profit split factors regarding interaction with EU users, other relevant functions, assets and risks in the value creation process should be considered (with regard to (i) "traditional" activities, (ii) non-traditional methods of value creation that are not related to the user base, and (iii) the value that the counterparty may apply with respect to its users in non-EU countries).. If some factors (such as user factors) are listed specifically in the wording of a Directive, and others (which may generate more value) are not, then this could be misinterpreted that the listed factors are always more important.

We recommend against such a prescriptive list. However, if a list (like the one included in the Draft Directive) is to be included, it should be as comprehensive as possible. Other factors that should be considered include:

- Investment costs (including historic investment costs) incurred developing the platform generally (as opposed to specific investment on localisation for the EU country in question);
- Research and Development activities;
- Data consolidation and processing activities;
- Location of management decisions regarding the development, enhancement, maintenance, protection and exploitation of the platform;
- Risk assumption;
- Financing costs; and
- The value contributed by users in other (non-EU) countries.