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3 January 2018

## ***European Commission Survey on “Fair taxation of the digital economy”***

### ***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 survey on *Fair taxation of the digital economy* (“the Survey”).

#### **The broader context**

We welcome the European Council ECOFIN’s conclusions on ‘Responding to the challenges of taxation of profits of the digital economy’, which supports a detailed examination of value creation and profit generation, confirms that taxes should be paid where value is created (Annex I paragraph 6), and recognises the importance of close international cooperation (Annex I paragraph 21) and the broader economic impact of any solutions (Annex I paragraph 25).

We believe that the OECD’s Inclusive Framework is best placed to deliver such a consensus to avoid potential unilateral actions that would have a negative impact on cross border trade and growth, and encourage the EU to be a leader in these discussions. Short term solutions that will adversely impact the coherency of the international tax system, could invite retaliatory action, and may stand in the way of a long term global consensus on these important issues. We are concerned that some countries have implemented or are implementing unilateral measures - particularly where these measures are turnover based and not creditable against other taxes paid (e.g. India, Italy). As well as specific concerns raised on such approaches (as detailed in the Appendix to this letter), the lack of coordination could harm the prospect of a globally coordinated approach and unnecessarily increases the administrative burden on taxpayers.

As and when global solutions to these challenges are agreed, unilateral changes made at the EU or EU Member State level need to be aligned with them. Countries should be prepared to withdraw unilateral short term measures when global consensus is reached. Solutions, and certainly more sustainable international tax framework changes need to adhere to the principles of good tax policy design to provide the certainty needed to foster investment and growth during the coming years of transition..

We commend the international efforts to address the tax challenges of the digitalisation of the economy. The BEPS Action 1 report identified these as “broader tax challenges”, and set out a timeline to monitor the impact of the BEPS recommendations and other changes to the economy. It was agreed by all participating countries at that time that any unilateral action to address such challenges must respect existing treaty obligations, and we continue to endorse this agreement.

### **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. Transfer pricing rules are increasing exponentially in number and complexity, and have resulted in high compliance and enforcement costs and increased risk of double taxation.

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.

Naturally, even 30 years ago, it was possible for French wine growers to send boxes of wine to Dutch customers without being physically present in the Netherlands. This type of trade is not normally classed as permanent establishment. The great speed with which information and communication technology is developing means the same French winegrower can upscale his activities in the Dutch market without being physically present in the Netherlands (and may even allow him to engage more easily with consumers, rather than intermediaries). However, all marketing, sales, distribution and after-sales activities may still take place in France; in that sense, the location of where the value has been created has not changed, and digitalisation has merely opened up new markets and reduced barriers to growth. It is hard to understand why the French wine grower's digital access to the Dutch customer should be considered to yield a different tax result than the result with the customer access of decades past.

### **Recommendations**

We recommend 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 some countries. That framework, which we discuss in detail, should lead to a greater understanding of the characteristics of digitalisation, the reasons businesses adopt elements of new business models (which will keep evolving), the extent to which profitability and growth profiles drive behaviour over time and how this impacts with people, capital and risk issues.

Solutions adopted need to be 'fit for the future' and be capable of addressing the rapid development of digital techniques. Business models as well as processes will evolve, so it is characteristics that need to be targeted rather than the existing models.

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 - withholding taxes and equalisation levies would inhibit growth with significant potential for double taxation. Countries will benefit from a bigger pot even if the tax share is smaller (not to mention the additional non-financial benefits to consumers and societies that increased digitalisation can bring).

PwC is of the opinion 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;
- there is a need to understand how value is created in digitalised business models and whether this is different from traditional businesses;



- unilateral actions 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.

### 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.

### Next steps

The Appendix to this response outlines our thoughts about features of digital business models and the Commission's proposed solutions. We hope that these will be of use to the Commission in analysing the current and expected future states, and developing proposed solutions to lead discussions with at the OECD.

For any clarification on this response, please contact the undersigned or any of the contacts 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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## ***1. Features of modern business models***

- 1.1. Before any changes are made to the tax system, our recommendation is to develop and obtain consensus on a framework to evaluate “value creation” within the digitalising economy with the purpose of first evaluating the adequacy and appropriateness of existing rules before considering options that might change how and where this “value” should be taxed and where.
- 1.2. This framework could include the following inputs:
  - understanding the unique features of the digital economy which lead to the creation of digital business models;
  - deep understanding of how digital business models function and how revenue is earned and costs are minimised;
  - how profitability may be affected; and
  - what is value creation and how do any new assets or value drivers interact with existing assets and impact people functions, capital and the analysis of risks.
- 1.3. We will briefly introduce the framework on an illustrative basis to provide some direction and explanation of how the digital economy and business models are truly disruptive and different, with a view to informing the debate on the tax challenges they pose.
  - 1.3.1. Digital business models originated from a need to serve customers better and at a lower cost and digital technologies could make this possible. Social media, mobile phones, and platforms allowed for a greater understanding of customer needs and the ability to build a stronger relationship with customers to continue to improve the customer experience. Serving customers with the best products or services at the best price has always been the objective of business. Now with greater customer insights and technology capabilities, digital business models are meeting that objective differently than traditional business models. But customers are not the only value driver.
  - 1.3.2. Our key observations about the business models of “digital” businesses (and the impact of digitalisation on existing business models) are that:
    - they overlap and may be combined, as discussed in BEPS Action 1;
    - they will continue to evolve as emerging technologies such as Artificial Intelligence, Blockchain and Internet of Things (IOT) advance and new ecosystems emerge;
    - they include new ways to maximise revenues and reduce cost; and
    - they are able to leverage data, technology platforms, and customer relationships, etc in innovative ways.
  - 1.3.3. There are no universally accepted definitions of digital business models but several broad types have emerged. BEPS Action 1 describes most of these models in detail so we will identify them only briefly. There are four broad categories of digital business models, which are defined mainly by how they generate revenues and engage customers/users:
    - (A) e-Commerce/ Online retailer model
      - trading through online platforms of “bricks and mortar” businesses ;
      - trading through “digital only” offerings; and
      - consumers trading with each other.

(B) Platform models -

- multi sided e-commerce platforms that allow two or more customers or groups to connect with each other through an online platform;
- cloud platforms that could take the form of Platform as a service or Software as a service model; and
- IOT platforms, whether connecting industrial equipment and machinery or cars or even people; and
- payment platforms and use of mobile wallets by consumers and mobiles in point of sale by merchants.

(C) Social media/Online advertising model

- location based;
- behaviour based; and
- other ways of differentiating users.

(D) On demand/ Subscription model - in particular

- the subscription model locks in a customer by taking a product or service that is traditionally purchased on an ad hoc basis and charges a subscription fee for continued access to the product/service; and
- the “freemium” model lets users sample the service for free and then charges to upgrade to the full offer.

1.3.4. Mapping a company’s business model maturity will be important to understanding its profitability and how that is impacted by two factors:

- the investment required to reach a level of maturity that is viable, profitable and sustainable; and
- when commoditisation begins to occur with a product or service such that margins begin to drop – a late comer to an innovation will not reap the same benefits and profitability as a company at the forefront of innovation.

1.3.5. Digital technologies have changed the way an organisation may be able to create value:

- new value could be increasingly captured by data, platforms and customer experiences;
- the combination of these value drivers will differ in each business model and may give rise to new intangible assets/IP; and
- disruption is not new, but never before has disruption affected all industries or happened so fast and it continues to pick up speed so that businesses have to re-think and sometimes re-invent their business models to survive.

1.3.6. Data may become valuable through the business outcomes it makes possible but it is still to be decided whether the existing international framework can accommodate this or how it needs to be adjusted. Data comes in many different forms and from many different sources. It could be structured or unstructured, public or private. Companies can create proprietary data sets. These type of factors need to be considered to assess the value of data before any data analytics or transformation of the data occurs to add value. It is interesting to consider the comments on data in the submissions made to the OECD in relation to its request for information on the digital economy which broadly agreed:

- raw data has little or no value
- value of data is a function of what you do with the data (i.e. analyze, aggregate, algorithms, etc.)

- additional value is created by the interaction of data with “digital drivers” (i.e. platforms, user base, digital culture)

1.3.7. We would recommend that consideration of the value created by data, whether in its raw form or refined form, should specify the type of data that is referenced as data has a broad definition. Currently, most of the proposals and unilateral country measures apply to customer /personal data used by ecommerce and marketplace digital business models. However industrial companies, both traditional ones and new emerging companies, are amassing IOT data which is being accessed and collected across borders. There is more detail in the Report on our [2016 Global Industry 4.0 Survey](#)<sup>1</sup>, the biggest worldwide survey of its kind, with over 2,000 participants from nine major industrial sectors and 26 countries.

1.3.8. By investing in data analytics capabilities, companies can uncover insights whether it is to identify new products or services, serve customers better, make operations more efficient or improve employee engagement and retention. More specifically, it may be necessary to consider whether value may be extracted through data analytics to produce these actionable business insights or further develop into algorithms and apps. Some algorithms or apps may be publicly available so it cannot be automatically assumed that all algorithms or apps are valued the same.

1.3.9. Platforms provide connectivity and provide the ability to scale quickly. Convenient access to platforms in the cloud has replaced the need for significant capital expenditures in hardware and software. It may be possible for value to be created by:

- opening communication channels and initiating transactions between various consumers and producers so that platform owners can observe and incorporate its users’ behaviours and preferences to drive changes to its value chains, products and services, and
- the ability to scale quickly to enable companies to attract users to reach a level of adoption that sustains the business model and realise the network effects.

1.3.10. Where product and price differentiation is no longer sustainable, focusing on delivering superior customer experiences is key. Multiple channels and devices mean that companies have more ways to reach customers, but customers also expect to use their preferred methods at each stage, and on their own time.

## ***2. The post-BEPS tax environment***

2.1. The OECD has committed to reviewing the implementation phase of BEPS in 2020 and at that point it will be necessary to determine whether sufficient time has passed to identify a clear picture of the impact of these changes. BEPS Action 1 was included in this agreed review, and additional work is being undertaken now for an interim report in April 2018. When sufficient time has been provided for implementation of the direct tax measures, and any indirect tax (VAT/GST) measures have been reviewed and introduced, it will only then be possible to truly determine what additional measures (if any) are necessary to tackle the challenges of the new economy.

2.2. However, we recognise that there is a need to address concerns arising from the digitalisation of the economy in advance of this timeframe. In order to be as successful as possible, and minimise

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<sup>1</sup> <https://www.pwc.com/gx/en/industries/industries-4.0/landing-page/industry-4.0-building-your-digital-enterprise-april-2016.pdf>

unnecessary disruption and complexity, the most sensible focus for any short term measures should be agreed in the light of the level of consensus already achieved and the planned . Furthermore, any temporary solution should not be introduced without a sunset clause that revokes the temporary solution when global consensus is reached. Revenues from temporary measures should not be regarded as structural.

## **2.3. Direct Taxes**

2.3.1. The delivery of the BEPS reports in October 2015 has given countries a number of recommendations to consider and implement. The implementation phase proposed by the OECD was from the date of release in October 2015 until 2020, and given the level of technical legislative change required this is a tight time frame. Aided by the multilateral instrument and EU Directives, significant progress has been made in addressing BEPS issues, and continues to be made. However, it is likely that the full impact will not be felt until 2020 and beyond.

2.3.2.. We have outlined here the progress and impact of some of the actions expected to address BEPS issues and broader challenges raised by the digital economy (or the new digitising economy as a whole), which must at least be considered if proposals are to be coherent in the medium and long term.

### **2.3.3. Action 7 - Permanent Establishment**

2.3.3.1. Two significant changes brought forward by Action 7 centred around the dependent agent test and the specific activity exceptions. The reduced threshold for a dependent agent means that (where countries have adopted the relevant MLI provisions or negotiated bilaterally to the same effect - see 2.2.3.3), it is significantly more difficult for a company to avoid recognising a PE in instances where that company habitually has people in a jurisdiction who play the principal role leading to the conclusion of contracts. Hence it will no longer be possible for the sales of goods or services by digital companies to not be subject to tax in locations where they have related parties playing a principal role leading to the conclusion of those sales. This is a potentially significant shift from the pre-BEPS landscape.

2.3.3.2. Similarly, one of the recommendations relating to the specific activity exemptions is that they should only apply where the activities themselves are preparatory and auxiliary in nature. This, for example, would mean that the storage of goods for delivery may constitute a PE for an online company whose logistics operations are not merely preparatory and auxiliary to the rest of the business. The anti-fragmentation rules mean that it will not be possible to separate activities to avail of these exemptions (where countries have adopted the relevant MLI provisions or negotiated bilaterally to the same effect - see 2.2.3.3).

2.3.3.3. The PE rules can be adopted by countries through the MLI. Some countries have indicated that they will not adopt these rules in their treaties due to either the factor not being a risk for their jurisdiction due to domestic legislation, or due to the lack of clarity on the profit that must be attributed to PEs. This is a continuing area of debate and we acknowledge that public consultations have been undertaken in 2016 and 2017. We await the outcomes of this work stream. It is likely that further guidance and clarity on profit attribution would lead to more jurisdictions gaining comfort on adopting these new standards.



#### *2.3.4.Actions 8 - 10 - Transfer Pricing*

- 2.3.4.1. The revised OECD Transfer Pricing Guidelines (“the 2017 OECD TPG”, which have been recently released) draw a clear distinction between the return due to the mere legal ownership of an intangible and the return due for the DEMPE functions that contribute to the value of the intangible. Alignment of profit with the functions which create value is a cornerstone of the BEPS project and the outcomes of this action should be appraised in advance of any other measures being introduced. Furthermore the introduction, or modification, of CFC rules (as proposed by Action 3 and implemented in the EU through the Anti Tax Avoidance Directive) will act as a backstop to these transfer pricing initiatives in tackling the mobility risk commonly associated with the digital economy.
- 2.3.4.2. The increased and standardised documentation that has also been included in the 2017 OECD TPG as a result of the recommendations from BEPS Action 13 will also mean that tax administrations will have a much greater understanding of the functions being undertaken in their jurisdictions by companies (including digitalised functions) along with how they fit into broader value chains through detailed Master Files and Local Files. Tax administrations will also benefit from country by country reports, which give them the information they need to perform high level risk assessment and focus their resources.

#### *2.3.5.Action 5 - Preferential regimes*

BEPS Action 5 examined preferential regimes, and reinforces the work undertaken as part of the transfer pricing actions. Setting rules relating to IP regimes and the instances in which preferential regimes are not deemed to be harmful has resulted in a wind down of certain structures and will, in conjunction with the TP actions above, result in a better alignment of profit with value creation.

### **2.4. Indirect Taxes**

- 2.4.1. BEPS Action 1 highlighted two key areas of challenge that the digital economy raises for indirect taxation with respect to remote digital supplies to consumers and exemptions applied to the importation of low value goods. The report also described various options to address these challenges, some already implemented by the EU and some under consideration.

#### *2.4.2. Remote digital supplies to consumers*

- 2.4.2.1. Following BEPS Action 1 and the updated OECD International VAT/GST Guidelines that were adopted in 2015 and endorsed by more than 100 countries at the Global Forum on VAT in November 2015 as the preferred international standard for the application of VAT/GST to cross-border services, 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.
- 2.4.2.2. Many of the new collection models follow, at least at a high level, the general principles of taxation set out in the OECD’s VAT/GST International Guidelines and indeed the EU’s approach should certainly be viewed as a global frontrunner on the basis that the B2C

simplified vendor registration model (ie, where the non-resident supplier is required to register and account for VAT on B2C supplies in the jurisdiction of the consumer) was implemented across the EU with effect from 1 January 2015. However, the speed and scale at which changes are being announced around the world has produced a wide variety of challenges for businesses operating in the global marketplace due to inconsistent implementation at an international level, even where governments have tried to keep compliance obligations for foreign vendors as simple as possible.

2.4.2.3. The result, even if overall the broad aims of the rules are similar, is a great array of legal and administrative practices established by different countries. Our experience is that even simple and flexible rules can still result in significant complexity if there is limited coordination between different countries in addressing what are effectively global issues. Therefore, in our view, whilst the B2C simplified vendor collection model is the preferred approach and for which the EU is a leading proponent, more consistency is required between jurisdictions to ensure that there is greater efficiency and cost effectiveness whilst safeguarding tax revenues.

#### *2.4.3. Import of low value goods & the role of online platforms*

2.4.3.1. One hotly debated topic around the world right now is the cross-border supply of goods facilitated by the internet, including the role of online platforms and intermediaries in the VAT collection process, as well as the interaction with the VAT exemption for the importation of low value consignments, and customs processes generally. BEPS Action 1 set out an overview of the relevant issues for consideration and provided a number of possible approaches to address them.

2.4.3.2. In this context, on 5 December 2017 the Council of the European Union agreed to adopt the VAT e-commerce package covering a number of important areas to be implemented by 2021, including moves to extend the Mini One Stop Shop (MOSS) to the B2C sale of goods and non-electronic services, 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.

2.4.3.3. These 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, as highlighted in BEPS Action 1, the complexity inherent in this area is considerable, given the wide variety of new and constantly evolving business models with different parties involved in the value chain performing different functions. Accordingly, there is no likely one size fits all solution, and the practical aspects will need 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, in order to ensure a level playing field and to promote growth in this rapidly expanding market, 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.

2.4.3.4. To date, only Australia has produced detailed legislation to charge VAT (GST) on low value imported goods, with their changes set to apply from 1 July 2018. However, in a far larger and more diverse marketplace such as the EU, it will be critical for the Commission

to engage widely with business in order to understand the commercial environment (what is feasible and what is not) when considering the detailed Implementing Regulation, particularly given the fact that some of the measures (eg, extension of the scope to online platforms) have been brought into the Council negotiations by Member States with no prior consultation with business. We would stress the need to take measured and informed decisions to ensure legislation that is practical, simple and effective.

2.4.3.5. These matters are also being discussed in the OECD VAT/GST TAG process at the moment, and so 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.

#### *2.4.4. Proposed options & impact on VAT*

2.4.4.1. Whilst a variety of options are proposed 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 PE concept may affect the use of the MOSS or the application of the reverse charge mechanism. Therefore when considering these options from a broader tax perspective, sufficient resource must be dedicated to understanding the potential VAT consequences.

### **3. Key principles in tax policy design**

#### **3.1. OECD identified principles**

3.1.1. The OECD's Final Report on BEPS Action 1 (chapter 9) identified tax principles (based in part on the Ottawa Principles) of neutrality, efficiency, certainty and simplicity, effectiveness and fairness, flexibility and sustainability, and proportionality. We endorse these principles and consider that as proposals are developed they are assessed against them.

#### **3.2. Broader principles**

3.2.1. Given the breadth of the impact that digitalisation is having on the economy (and on business models), it is clear that changes to the taxation system may not have their intended impact if they do not consider:

- the potential for digitalisation to even further change business models in ways that have not been anticipated;
- the potential impact of competition on tax rates as a result of BEPS implementation and greater mobility in functions as outlined above;
- whether corporate taxation gives the whole picture of the benefits (including taxes collected) arising from a digitalised economy; and ultimately
- whether changes that may arise in the incidence of tax as a result of either changes to the economy, or the changes to the tax system<sup>2</sup> are as intended and desirable.

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<sup>2</sup> It is widely understood that the incidence of tax falls on individuals, or, (as is the case for all taxes paid by unnatural persons), groups of individuals. Taxes paid by businesses are ultimately borne by shareholders, employees, creditors, suppliers or customers. The allocation between these groups clearly depends on the underlying structure of the tax system, and the openness of the economies involved (in general, a larger relative burden falls on immobile factors).

3.2.2. The current corporate taxation system seeks to tax profits based on the value generated in each country, which impacts decisions made by businesses. Alternative forms of corporate tax have been considered, mainly in academic studies. Each is designed to target the yield from different contributions (e.g. total capital, labour, economic rent). The actual impact of fundamental changes to this system would be substantial, and should not be entered into without clear and agreed global objectives regarding the incidence of taxation, and a realistic and globally agreed understanding of the best way in which to realise those objectives. It would be preferable for any changes to be grounded in ensuring that each country's corporate tax base reflects the value generated in that country.

3.2.3. In addition, there are many policy reasons why governments have historically opted to exempt certain organisations or persons from taxes (e.g. charities). If there is a shift by individual countries, by the EU, or internationally, away from the traditional concept of taxing profits, such organisations and persons will be most adversely impacted unless they are also exempt from the new taxes. The Commission should consider whether such organisations and persons should be exempted from new taxes on digitalisation.

### **3.3. Growth**

3.3.1. Tax rules should align taxation rights with value creation, but pro-growth tax policies cannot be achieved without consideration of the impact on the broader economy, including detailed rigorous economic work, global cooperation, and compromise for the greater good (for example, where activity may in principle create a taxing right, this has historically been foregone by both treaty partners where a threshold has not been breached; recognising that there is a trade off between compliance burden and expected yield). We have encouraged the OECD to remind stakeholders of this point and urge the Commission to do so as well.

3.3.2. It should be borne in mind that as much as two thirds of global trade happens within value chains<sup>3</sup>. Taxes that disrupt these flows and transactions through administrative burden and double taxation (rather than, for example, reallocating the taxing rights between jurisdictions) could seriously hamper growth in all sectors of the economy.

## ***4. Review of the Commission's proposed options***

### **4.1. General comments**

4.1.1. The international tax framework proposed in the BEPS package seeks to align profit taxation rights with the economic activities where the corresponding value is created.

4.1.2. Advances in digital technology have not changed the fundamental nature of the core activities that businesses carry out as part of a business model to generate profits. To generate income, businesses still need to source and acquire inputs, create or add value, and sell to customers. Value creation is also critical to the digital economy and current rules amended in the BEPS

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<sup>3</sup> <https://www.brookings.edu/blog/order-from-chaos/2017/07/10/global-value-chains-shed-new-light-on-trade/>

Actions 8-10 recommendations provide the framework to identify value and align taxation with its creation.

- 4.1.3. The proposals in the Survey are departures from the existing international tax system and should be measured against the design principles identified in chapter 9 of the BEPS Report on Action 1, considering also the broader impacts on tax incidence and growth, and the BEPS objectives of aligning taxation rights with value creation. Our particular concern in this respect is that they would lead to a different treatment of the physical and digital economy, which will be difficult to sustain as the economy digitalises further.
- 4.1.4. Rather the taxation nexus must be based on taxation *in the jurisdiction where value is created*. This means that the approach used in calculating the taxable profits of the digital economy and determining the jurisdiction where those profits may be taxed should be based upon an analysis of where the value is effectively created. As in the physical economy, value may be created in the residence jurisdiction, in the market jurisdiction, in both jurisdictions or in a third jurisdiction. We do not consider that this question has been appropriately addressed in designing the three proposals.
- 4.1.5. We are particularly concerned at the assertion in the accompanying impact assessment, stating that “Member States’ public budgets will be impacted positively”. While we have not seen the underlying calculations behind this statement, Member States’ economies differ considerably and it would therefore be unlikely for this to be the case for all Member States. Perhaps more importantly, though, we are concerned that the impact assessment does not appear to consider the potential negative impact on growth that unilateral measures (that make EU businesses less competitive and discourage investment into the EU) would have.
- 4.1.6. Any approach to addressing tax challenges that arise as a result of the digitalisation of the economy should find its basis in the internationally agreed principles as agreed by the OECD / G20 BEPS project, and should discourage unilateral measures that would distort behaviour and discourage investment into the EU.

#### **4.2. Turnover based approaches (withholding tax on digital transactions, revenue tax on digital activities, and equalisation tax on digital services, and digital transactions taxes)**

- 4.2.1. Of all of the proposals for digital taxation, we are most concerned about the economic damage that taxes on turnover could bring. For the same reason as mentioned above (taxation in the jurisdiction where value is created) the digital equalisation levy is not an option that should be pursued. Like the concept of ‘significant economic presence’ such levy would aim for the turnover of digitalised enterprises without a link to the value creation in the jurisdiction where the equalisation levy is levied.
- 4.2.2. Moreover such levy would not consider the economic circumstances under which the digitalised enterprises operate and would pose a barrier to economic activity (in particular in markets or activities where the profit margins are already low), and a barrier to entry and expansion because it will tax loss making companies the same as profitable ones.
- 4.2.3. Another potential issue with turnover taxes are that they tax the same income every time a payment is made in a value chain. The EU already has a turnover tax, in the form of VAT, and,

appropriately, credit is given on output VAT for input VAT suffered, thus addressing this concern. Both withholding taxes and equalisation levies would lead to double (/ multiple taxation) and would significantly inhibit the potential of the digital economy to deliver economic growth.

- 4.2.4. Further, the compliance challenges (for either consumers, businesses, or both) from collecting the tax should not be underestimated. 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 registration requirements.
- 4.2.5. Additionally, it has been questioned whether turnover based approaches are in line with the freedom of establishment principle. If they are not, then they would not be in line with European Law (except to the extent they are restricted to abusive situations):
- 4.2.5.1. Assuming that the equalisation tax would be designed as a withholding tax on the payments made by a resident to a non-resident, it follows from the jurisprudence of the CJEU that a comparison would need to be made between the withholding tax faced by the non-resident in comparison to the overall tax burden of the resident.<sup>4</sup> Insofar as the former would be higher, the tax would likely be deemed to constitute a restriction under EU law since it hinders the establishment of a non-resident in another EU Member State from the host state perspective.
- 4.2.5.2. It is doubtful whether such a restriction could be justified by an overriding reason in the public interest and whether it could be considered proportionate. Since one of the primary aims of the equalisation tax would likely be to protect the tax base of the Member State in which services are being provided (i.e. due to the significant economic presence in that state but no PE therein), it could be argued that the equalisation tax is of anti-abusive nature. According to the jurisprudence of the CJEU, a national measure restricting the freedom of establishment may be justified where it specifically relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned.<sup>5</sup>
- 4.2.5.3. However, the specific objective of the restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality. The equalisation tax, subject to its design and scope, does not appear to be aimed at specifically tackling wholly artificial arrangements since it applies more broadly to all payments made to non-residents for the provision of certain services. It is therefore likely to not be considered a justified restriction under EU law. There is therefore no need to test the proportionality of the measure insofar as it is considered to not be justified. The same considerations apply insofar as the freedom to provide services/ free movement of capital is applicable and also if the equalisation tax is designed as a final withholding tax.
- 4.2.5.4. Given the recent CJEU judgment in the World Duty Free Group case,<sup>6</sup> it could also be argued that the non-levying of an equalisation tax for residents would selectively favour

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<sup>4</sup> CJ, Joined Cases C-10/14, C-14/14 and C-17/14 Miljoen, X, Société Générale SA, 2015. See also CJ, C-18/15 Brisal and KBC Finance Ireland, 2016.

<sup>5</sup> CJ, C-196/04, Cadbury Schweppes, 2006.

<sup>6</sup> CJ, Joined Cases C-20/15 P and C-21/15 P World Duty Free Group SA, Banco Santander SA, Santusa Holding SL, 2016.



them in comparison to non-residents as a result of which an EU Member State could be granting unlawful State aid (Art. 107 TFEU) to its own residents.<sup>7</sup> In case a final withholding tax is enacted which is applicable only towards digital transactions, this could also be problematic from a State aid perspective as it would selectively favour transactions that are carried out physically to the detriment of those carried out digitally. A selective measure can however be justified if the Member State concerned can show that that measure results directly from the basic or guiding principles of its tax system.<sup>8</sup> It is doubtful whether a tax applicable solely to digital transactions can be considered inherent to the tax system.

4.2.6. We urge the Commission to undertake the appropriate legal analysis (and ensure this is aligned with the Parliament and Council Legal Service opinions) before proceeding with such measures.

4.2.7. Finally, we note that many organisations (e.g. not for profit, charities) are exempt from corporate taxation for a broad range of policy reasons. Exemptions for such organisations from any non-profit based taxes should also be considered to ensure that they are not adversely impacted.

### **4.3. Nexus based approach (“digital presence”)**

4.3.1. The concept of a “virtual permanent establishment” is fraught with difficulty.

4.3.2. Unless arbitrary lines are drawn that encourage avoidance and break the neutrality principle, almost anything (and everything) could be a permanent establishment – live chat, an online order form, an interactive catalogue, etc. The result is that the concept of permanent establishment (which has historically required a degree of permanence, and an establishment) no longer seeks to balance the activities in one country with those in another – it simply asserts that there would always be a PE in the sales country.

4.3.3. Additionally, a move away from analysis of functions, assets and risks of the taxpayer would need new models for income attribution. In order to remain neutral, these same models would need to be applied to all businesses. It would be a significant challenge to identify such models, and it should not be desirable to do so without undertaking significant analysis on the potential impact on incidence and growth.

4.3.4. We consider that a swift move toward such a concept will not be met with universal agreement, and accordingly would expect additional complexity, uncertainty, and double taxation to arise.

4.3.5. We also question whether, in reality, it would meet the implicit objective of allocating more profits to market jurisdictions. Even if such an objective were achieved between EU Member States, no additional profits would be allocated to European countries from non-European countries because taxation treaties are based on the international tax framework (which is rooted in a different threshold). In fact, the additional burden may discourage non-EU headed groups from placing significant functions, assets, or risks anywhere within the EU, thus reducing the overall profits allocated to (and growth of) the EU.

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<sup>7</sup> According to the CJUE, a non-resident becomes comparable to a resident insofar as an EU Member State decides to tax a particular item of income for the non-resident but fails to provide relief for the double taxation resulting therefrom but does so for its own residents.

<sup>8</sup> CJ, Joined Cases C-78/08 & C-80/08 Paint Graphos, 2011.

#### **4.4. Formula based approaches (destination based corporation tax, unitary taxation, and common (consolidated) corporate tax base)**

- 4.4.1. While we recognise the Commission's desire to be thorough, we question whether such drastic departures from the existing international (and intra-EU) tax framework are appropriate or necessary, particularly (as noted above) before the objectives have been clearly articulated.
- 4.4.2. In order to avoid arbitrary lines (which would, in themselves, encourage avoidance) such systems would need to be introduced across all industries. Accordingly, the compliance burden on taxpayers and tax administrations, and the impact on business, trade, and investment would be significant. Such a decision should be considered very carefully.
- 4.4.3. The impact of such drastic departures from internationally agreed principles are unknown, because they are unprecedented. However, where we do see significant departures from international norms in regulation, there is generally a negative impact on investment and growth.
- 4.4.4. As with nexus based approaches, we again question whether, in reality, these approaches would even meet the objective of allocating more profits to market jurisdictions (see para 4.3.5). The risks to the EU are heightened in such approaches, because they are further from the agreed international framework, increasing the likelihood that investors seek to limit their activities in the EU. For example, credit may not be available under a bilateral treaty (or a domestic worldwide tax system) for taxes foregone by the Member State with which the treaty was agreed and collected on a different basis by another Member State.
- 4.4.5. Discussions around the common (consolidated) corporate tax base (CCCTB) as an EU-wide regime are ongoing. The Commission perhaps ought to consider the merits and demerits of new approaches being put forward by jurisdictions outside the EU as well as potential interactions between all the different approaches in inputting to the debate about global solutions. 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.