Opinion Statement FC 08/2017

Response to

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

Prepared by the CFE Fiscal Committee

Submitted to the OECD on 13 October 2017

The CFE (Confédération Fiscale Européenne) is the umbrella organisation representing the tax profession in Europe. Our members are 30 professional organisations from 24 European countries with more than 200,000 individual members. Our functions are to safeguard the professional interests of tax advisers, to assure the quality of tax services provided by tax advisers, to exchange information about national tax laws and professional law and to contribute to the coordination of tax law in Europe.
The CFE is registered in the EU Transparency Register (no. 3543183647-05).

We will be pleased to answer any questions you may have concerning CFE comments. For further information, please contact Stella Raventós Chair of the CFE Fiscal Committee, or Mary Dineen Advisor to the CFE Fiscal Committee, at brusselsoffice@cfe-eutax.org.

1 Introduction

This Opinion Statement by the CFE Fiscal Committee is in response to the OECD request for input on work regarding the tax challenges of the digitalised economy published on 22 September 2017.

We will be pleased to answer any questions you may have concerning our comments. For further information, please contact Ms. Stella Raventós, Chair of the CFE Fiscal Committee or Mary Dineen, Adviser to the CFE Fiscal Committee, at brusselsoffice@cfe-eutax.org.

2 General Remarks

CFE supports the conclusion reached by the BEPS Action 1 Report that because "the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes". The BEPS process involved long and detailed consultations with a broad spectrum of stakeholders, however, none of the three options identified in the BEPS Report were recommended at that stage nor was ring-fencing the digital economy endorsed. The digital economy cannot be ring-fenced and it is still not clear that the targeted taxation matters identified in the BEPS report, are appropriate. In particular, they violate the principle of neutrality, efficiency, certainty and simplicity espoused by the Ottawa Framework for designing tax policies for the digital economy.

Ideally, CFE believes the sensible approach is to allow the BEPS Project take effect and subsequently assess how problems which persist can be addressed in light of the new post-BEPS taxation framework. In practice we recognise the imperative that governments feel to be seen to "be doing something" but we would strongly recommend that the OECD needs to build a clear international consensus before it puts forward any clear recommendations. Not to do so would risk undermining all the consensus building that has surrounded the BEPS project itself.

CFE welcomes the publication of the Outline of the Interim Report for the G20 Finance Ministers and in particular Chapter II which will contain "Analysis of heavily digitalised business models and their value chains to shed light on how and where value is created" and a "Discussion of the tax system (both direct and indirect taxation) and the issues raised by the new business models, including the impact of digitalisation on a number of traditional tax bases and on tax systems generally (i.e. beyond BEPS)" . This will bring up to date the really helpful description and analysis contained in the 2015 BEPS Action 1 report and can form the basis for a detailed analysis of how there could be modifications, or additions, to existing tax regimes to address any lacuna in the taxation of the highly digitalised parts of national economies and international business.

It is important that any new taxes do not stifle the growth of the digital economy or discourage innovation. Further, any new laws should be restricted by threshold to only very large highly digitalised companies. Any new measures must focus on the formulation of growth-orientated approaches, which exploit the opportunities of digitalisation for economic growth.

In addition, any new tax which deviates from settled tax practice and the international tax framework will inevitably lead to great tax uncertainty for all stakeholders. Uncertainty will result in non-uniform application to entities and practices beyond the anticipated scope of the new laws. To mitigate this risk, any new legislation should be aligned, as much as possible with existing international practice and norms. Net income taxation within digital economy structures should be pursued to the maximum extent possible.

Double non-taxation is a problem, this is indisputable, equally indisputable is the problem of double taxation – and its negative effect on the world economy, consumers and taxpayers. It is extremely difficult to design a new tax that is not going to have unintended consequences and lead to double taxation. Any new tax must be designed in a manner to avoid double taxation, and must come within the ambit of double taxation treaties, otherwise the whole tax treaty system, which international taxation is built upon and network will be completely undermined.

In the event that any new measures are implemented, it is vital that more robust dispute resolution measures are implemented as envisaged in Action 14 of the BEPS project. Access to effective dispute resolution mechanisms has been identified by all stakeholders as a significant problem for taxpayers. The addition of one of these new taxes will further exacerbate scarce resources to deal with disputes, increase waiting lists before appropriate fora and ultimately contribute to increased tax uncertainty.

Finally, taxpayers' rights must be safeguarded. Implementation of any new tax must be done in a manner to avoid uncertainty for taxpayers, ensuring that sufficient information is provided. New tax obligations should not be overly onerous on taxpayers and proper controls should be exercised over tax obligations (particularly in the context of a withholding tax).

3 Response to section B

3.1 Question B1

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

After a time of immense change in the international tax environment, CFE believes that establishing legal and tax certainty in the international taxation framework is of the utmost importance and must become a priority of policy makers. Whilst CFE appreciates the importance of measures to tackle aggressive tax avoidance schemes and base erosion and profit shifting (BEPS), the balance of legislation must be redressed to promote certainty for taxpayers, and tax administrators. In addition, access to effective dispute resolution is a prevalent issue for business in the current time. It is probable that the introduction of a new tax on digital transactions will lead to increased disputes and uncertainty for taxpayers. The introduction of unilateral actions by states have led to increased uncertainty and despite the unilateral nature still have a global impact given the universality of the digital economy. Uncertainty is also arising due to problems with characterisation of transactions and income e.g. due to the *servicification* of production in the increasingly digitalised world.

3.2 Question B2

Implication of highly digitalised business models and their value chain on taxation policy & systems

It is clear that difficulty has arisen with aligning existing bases on which countries seek to establish their taxing rights with taxing highly digitalised business models. This is evidenced from increased disputes regarding value chains and profit attribution, such as the recent high profile case before the French Supreme Court in which the French tax authorities failed in their attempt to assert the existence of a PE by Google's Irish entity (Google Ireland Limited) in France and consequently levy 1.2 billion euro in tax.

Opportunities to improve tax administration services and compliance strategies created by digital economies.

With respect to the opportunities for the tax system, it must be stressed that digitalisation is a prime opportunity to develop an improved tax system, that is less burdensome and more fair. For example, the potential of blockchain technologies should be explored in this respect.

4 Response to section C

4.1 Question C1

Although still early in the implementation of the BEPS package, how have the various BEPS measures (especially those identified at particularly relevant for the digital economy – i.e. BEPS Actions 3, 2, 7 and 8-10) addressed the BEPS risks and the broader tax challenges raised by digitalisation? Please feel free to support your answers with real life examples illustrating these impacts.

It is simply too early to give an informed opinion on how the BEPS package has addressed the BEPS risks and the broader tax challenges raised by digitalisation. For example, within the EU the Anti-Tax Avoidance Directives[1] ("ATAD") and the proposed amendments to ATAD pursuant to the second Anti-Tax Avoidance Directive[2] ("ATAD 2") have not yet been implemented in Member States, and will not be for a number of years[3] . Great uncertainty still exists as to how new guidance, principals and practices espoused under the BEPS Action Plan will work in practice, be interpreted by tax authorities or ruled upon by the courts. It needs time to take effect, to assess its impacts, positive and negative.

As an example, great uncertainty exists over the profit allocation rules in light of the changes made by BEPS Action 7 and the interaction with BEPS Actions 8-10. Introducing new methods of allocation to the digital economy would lead to further confusion without having a clear view of how the changes under the BEPS project may have impacted the digital economy.

4.2 Question C2

VAT/GST changes agreed in the BEPS Package to level the playing field between domestic and foreign suppliers of intangibles and services.

These changes demonstrate the difficulties of trying to address one problem and acting too quickly. The result is an inconsistent approach between digital and paper versions of the same product, which is unhelpful.

It should be noted that in relation to VAT the issue is very often misunderstood. While it is clear to tax practitioners that VAT is neutral in B2B transaction, and therefore even in case a B2B transaction between a non-resident digital business and a resident business is not taxed, VAT will be fully collected at a later stage, policy makers tend to believe that that case would result in a loss of tax. The focus should be addressed mainly on B2C transactions.

5 Response to section D1

As regards the three proposed solutions in this section before detailed comment can be made the proposals need to be enhanced with more substantial detail; more concrete details are required on key concepts such as applicable thresholds, to the extent this is possible.

[1] Council Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.
[2] Council Directive amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries
[3] ATAD provisions must be implemented in Member States before 1 January 2019, or 1 January 2020 in the case of exit taxes. The provisions of ATAD 2 must be implemented by 1 January 2020 or 1 January 2022 for reverse hybrid mismatches.

In addition much greater information must be ascertained on the serious impact that is to be expected. As results in the OECD Taxation Working Paper No. 32 2017[4] demonstrate, not always the tax burden is not always is held by the person who is legally responsible for the payment.

> *"In practice, the discussion regarding who bears a tax is often linked to the assumption that the economic burden may align with the legal tax liability. In reality, there can often be large and unintended differences between legal tax liability and ultimate economic incidence. In fact, legal tax liability often bears little relationship to who actually bears a given tax. Moreover, the dynamics whereby a tax burden is reallocated among different actors in the economy are not reflected in tax collection amounts, making economic incidence difficult to analyse".*

Being an organisation of tax professionals and not economists, CFE is not in the position to assess whether and to what extent any of the proposed "digital tax" will be effective with respect to it being borne by the intended targets. Nevertheless, by considering the OECD study, it is clear that to some extent (document says from 30 up to 50% for CIT and from 100 110% of any other indirect tax) any additional tax charged to the Digital economy will end up to an increase of costs for consumers and/or for workers.

Therefore, policy makers should assess these policy options in the context of the actual incidence of the chosen digital tax, and bear in mind that the effect will not be a mere increase of tax collection; most likely digital business will simply pass on part or the whole of that tax to consumers, with adverse consequences for consumers.

5.1 Tax nexus concept of "significant economic presence"

General remarks

This concept is at variance with the conclusion reached by the BEPS Action 1 Final Report, which CFE agrees with, that the digital economy cannot be isolated from the economy as a whole. Given the novel and nebulous nature of this concept, double taxation is invariably going to occur, along with increased level of disputes, increased tax uncertainty and opportunity for new arbitrage.

Specific Answers

I. It will be very difficult to select the extent a transaction must be "digital" and fall within the scope. It would be very important to clarify the relation between digital presence and significant economic presence. Every website, digital transaction and element of a digital

[4] Milanez, A. (2017), "Legal tax liability, legal remittance responsibility and tax incidence: Three dimensions of business taxation", OECD Taxation Working Papers, No. 32, OECD Publishing, Paris. http://dx.doi.org/10.1787/e7ced3ea-en

transaction has at some point human involvement at a physical location. When deciding what transactions should be included within the scope equal consideration should be given to start-up companies and SMEs which also rely on digital platforms to carry out their business. Further, it should be noted that any possible changes and increased administrative and compliance cross-border burdens will disproportionately affect the ability of smaller enterprises to carry out and expand their business domestically and cross-border. Similarly, the cost of double taxation will adversely affect SMEs far more the MNEs. In this context, at EU level new minimum thresholds are being introduced as part of the changes to the MOSS system to alleviate compliance burden for small business providing online B2C e-commerce services across borders. Further simplification measures are also proposed to alleviate the burden on SME.

II. Similarly, defining or imposing a threshold under which a digital presence will be established will be problematic. Regardless of how it is measured or determined, once it is based on the concept of "significant economic presence" it will lead to a two-tier system of taxation with a complete divergence in the basic principles underlying that taxation of the digital economy and "traditional economy".

III. Similarly in relation to attributing value, emphasis purely on where goods are supplied to, deviates from the current OECD and international tax principles that value should be attributed to criteria such as where functions are performed, risks assumed and assets utilised.

IV. CFE believes that the imposition of taxes based on something as vague and imprecise as a "significant economic presence" will result in double taxation. In the case that this option is pursued it is vital that the issue of double taxation is equally addressed.

5.2 Withholding tax on certain types of digital transactions

General Remarks

Whilst, this proposal may *prima facie* appear to be the most straightforward, on closer examination the administration of such a tax poses major obstacles, namely who should bear the burden of applying the withholding tax. In addition to the fundamental problem of administration, this proposal would increase the compliance burden on all parties to a digital transaction, result in unequal tax treatment of the same goods sold cross-border via digital or in the traditional means and will lead to double taxation.

The adverse impact on SMEs and start-ups could be detrimental to profitability and future growth, and it is likely to disproportionately affect SMEs in comparison to MNEs.

Finally, as highlighted at above, in reality this tax will be passed onto the consumer in the form of higher prices or lesser service offering.

Specific Answers

I. As outlined above in the context of the concept of a "significant economic presence" it is very difficult to delineate transactions which should come within this definition. It is likely that no matter where the line is drawn, it will appear arbitrary and will encompass some transactions not suitable to a withholding tax. If implemented the definitions should be drawn in as narrow a manner as possible so as not to capture unintended transactions. This is particularly at the beginning test phase of the new tax.

II. The threat of double taxation could be mitigated by ensuring that an appropriate clause is negotiated into double taxation treaties or a clause inserted to the OECD Multilateral instrument[5] to allow an appropriate credit / exclusion but again quantifying this in practice will be very difficult. It will lead to an increase in disputes and increased administrative burden.

III. The primary issue on implementation is choosing an appropriate withholding tax agent. The obvious choice is financial institutions but when ones delves deeper it becomes clear that this would be an impossible task for financial institutions. How are they to assess which online payment transactions fall within the ambit of the withholding tax? How are they to carry out the function? Given this tax is largely aimed at B2C transactions it is wholly impractical to require the customers to withhold the tax. Finally, as previously stated in practice it is highly likely that the cost of any withholding tax will ultimately be borne by the consumer and not the MNEs which the measure aims to tax.

IV. In terms of implementation it may be instructive to examine the commentary and debate relating to the 2017 introduction of Article 12A into the U.N. Model Tax Convention allowing for a gross source tax on payments for technical services at bilaterally agreed rate. Instructive also was the necessity to introduce alternative options in the relevant Commentary due to failure to reach full consensus.

5.3 Digital equalisation levy

General Remarks

[5] At the 2017 IFA Congress in Brazil, Mr. Saint-Amans identified the MLI as a viable tool in implementing future changes where general consensus is reached.

CFE is opposed to the introduction of a digital equalisation levy. A levy based on turnover would ignore different operational models that could distort competition further and result in an over burden on some business models whilst having no impact on others targeted.

In particular, CFE believes the introduction of a digital equalisation levy would:

I. Undermine the long established transfer pricing principles and undermine the assumptions on which OECD transfer pricing guidelines are based (people functions risk) if different allocation keys are used.

II. Lead to a two-tier tax system, / means of allocating profit – one for the "traditional economy" and another for digital.

III. Adversely impact smaller consumer economies (i.e. smaller countries) if it is heavily weighted in terms of sales.

6 Comment on domestic tax measures which have been introduced to address the direct tax challenges of highly digitalised business models

6.1 U.K. Diverted Profit Tax

The UK introduced a Diverted Profits Tax (DPT) with effect from January 2015, in the middle of the BEPS Action Plan, to prevent the artificial avoidance of a Permanent Establishment or the diversion outside the UK of what would otherwise have been UK, taxable, profits. The measure was designed to discourage such behaviour and included a higher rate of tax on such profits, 25 compared with the headline corporation tax rate at the time of 20%. The measure was introduced, so we were informed, to discourage undesirable behaviour by a very limited number of companies but the broad nature of the measures, and the lack of precise targeting, has meant that most large international businesses are potentially caught and it has created a very considerable compliance burden to demonstrate to the UK tax authority, HM Revenue & Customs, that the particular business is outside the DPT provisions. DPT was also designed to be a separate tax, outside the existing UK Double Tax Agreement network, which seems contrary to the collaborative spirit underpinning the BEPS Action Plan.

6.2 Italian Web-Tax

Italy introduced the so-called Web Tax by virtue of Law Decree 50/24.4.2017 which came into effect in its current form on June 24th, 2017. Remarkably, the adoption of the above legislation follows two failed attempts to tax digital economy – in 2014 and 2015 – but also a number of tax dispute settlement agreements with web companies, including Apple (in 2015 for € 315,000,000 and Google (in 2017 for € 300,000,000).

The Web Tax legislation forms part of the Italian Budget Correction Law for 2017 and is structured as voluntary disclosure regime, introducing targeted procedures instead of new taxes.

In brief, the provisions are addressed to multinational corporations fulfilling the following conditions:

i. Have consolidated revenue over € 1 billion;
ii. Provide goods or services in Italy for total annual value over € 50 million;
iii. Provision of goods/services in Italy is effected either directly or using an Italian affiliate;
iv. Do not constitute subject of investigation by the Italian tax authorities.

Such corporations may activate a *reinforced cooperation procedure* with a view to identifying jointly with the Italian tax authorities any debts of potential Italian permanent establishment (PE). In essence, the corporation shall request through respective application assessment of the existence of Italian PE by the tax authorities. If a PE is indeed identified, its tax debts for past tax years shall be the subject of joint evaluation (by the tax authorities and the corporation). Once the debts are agreed and paid through the so-called *verification with acceptance* mechanism, the corporation may benefit from:

I. reduction of applicable administrative penalties by 50%; and
II. non-application of criminal penalties.

In addition, the corporation can access the Italian cooperative compliance regime, which provides for a number of benefits in the long term, on the basis of mutual transparency and cooperation.

Taking into account that the above described legislation has just been introduced, it is too early to assess its impact. In addition, issuance of further implementing regulations is expected to complete the legislative framework. Nevertheless, any unwanted implications may not be expected to be important, considering that the legislation:

I. introduces tax-related procedures (and not new taxes) and
II. is based on voluntary compliance.

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