CFE tax advisers europe

OPINION STATEMENT

# Opinion Statement FC 1/2018 on the European Commission proposal of 21 March 2018 for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services

## Prepared by the CFE Fiscal Committee
## Submitted to the European Institutions in May 2018

CFE Tax Advisers Europe is a Brussels-based association representing European tax advisers. Founded in 1959, CFE brings together 30 national organisations from 24 European countries, representing more than 200,000 tax advisers. CFE is part of the European Union Transparency Register no. 3543183647-05. We would be pleased to answer any questions you may have concerning our Opinion Statement. For further information, please contact Ms. Stella Raventós, Chair of the CFE Fiscal Committee or Aleksandar Ivanovski, Tax Policy Manager, at info@taxadviserseurope.org. For further information regarding CFE Tax Advisers Europe please visit our web page http://www.taxadviserseurope.org/



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## Executive Summary


- CFE appreciates the pivotal role that the European Union and its Member states are playing in addressing the challenges of taxation of the digital economy, seeking to reach and contribute to a global solution to these challenges and working together with the OECD. Furthermore, CFE acknowledges the efforts of the European Commission to bring about progress in this complex area of tax law and policy.

- CFE's strong view is that the European Union and its Member states should focus on a long-term and sustainable taxation solution, in line with the Ottawa Taxation Framework Principles of 1998 when legislating for emerging sectors of the economy.

- CFE acknowledges the OECD BEPS Action 1 proposition that the digital economy should not be ring-fenced from the rest of the economy for tax purposes due to the increasingly prevalent nature of digitalisation and the evolving nature of the business models under scrutiny.

- Equally, CFE recognises the political imperative to take meaningful action to tax profits of multinational groups with digital business models, which are currently subject to only a very low effective rate of tax. The public perception is that these companies are not paying 'enough' tax. However, comprehensive reform takes time and is best achieved through consensus, taking into account the principles of neutrality and simplicity in designing legislation, which will maintain the growth and competitiveness of the European economies.

- At a general level, digitalisation continues to be an evolving process and an opportunity for society at large. As such, the digitalisation of the economy, the new business models and the consumer value it brings should be welcomed.

- CFE believes that in absence of international tax policy consensus on the features of the various business models in the digital economy, the digitalising traditional business models as well as a concurrent review of the 'nexus' and 'profit allocation' concepts, unilateral actions could compound existing shortcomings and aggravate competiveness and growth risks in the Single Market. Accordingly, contemplated interim measures on taxation of the digital economy need to be considered carefully, weighing the expected revenue from this tax against the potentially adverse impact. Once implemented, interim taxes tend to become permanent, hence such taxes need to be introduced with caution.

- CFE believes that establishing tax certainty in the international taxation framework and protection of taxpayers' rights is of utmost importance and must be a priority for policy makers. Whilst we appreciate the need to take action, solutions for taxation of the digital economy need to avoid double or multiple taxation and avoid discrimination of non-resident businesses. Equally, any new taxes need to be within the ambit of existing double tax treaties yet provide access to effective dispute resolution mechanisms.

# 1. Introduction

This Opinion Statement sets out the CFE Tax Advisers Europe views on the European Commission proposals for digital services tax on revenues resulting from certain digital activities in the EU Single Market ("DST" or "the proposal")[1].

The CFE has also commented on this matter in the context of the OECD and EU Commission consultation process: in October 2017 in response to the OECD request for input on work regarding the tax challenges of the digital economy, and, in December 2017 in response to the 2016 EU Commission public consultation on the fair taxation of the digital economy. This Opinion Statement complements these previous opinion statements.

CFE will consider responding separately to the European Commission proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence and the Commission Recommendation relating to the corporate taxation of a significant digital presence.[2]

# 2. Key Policy Considerations

It is now widely recognised that the digital economy poses unique tax policy challenges for policymakers. The immediate concerns are twofold:

- The existing international tax rules are unable to fully address the concerns related to the increasing reliance on data and B2C sales in host jurisdictions;
- Some multinational group companies with digital business models are currently subject to only a very low effective rate of tax, with a public perception that these companies are not paying 'enough' tax.[3]

More generally, the EU has been at the forefront of efforts to implement anti-BEPS measures including those that address base-eroding practices associated with the digital economy. As a result, many of the enacted

[1] Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services of 21.3.2018 COM(2018)148

[2] In respect of the long-term proposals addressing the tax challenges of the digital economy, CFE will consider issuing a separate Opinion statement on basis of developments as set out in the Presidency digital taxation roadmap: http://data.consilium.europa.eu/doc/document/ST-9052-2018-INIT/en/pdf

[3] Digital businesses models in the EU face a lower effective average tax rate than traditional business models, as evidenced by the European Commission Impact Assessment. ZEW (2017) finds that a cross-border digital business model is subject to an effective average tax rate of only 10% compared to a rate of 23% of a cross-border traditional business, with more than one factor accounting for such a difference; European Commission Impact Assessment accompanying the Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, SWD(2018) 81 final/2, page [136]

measures at EU level, which implement BEPS policy outcomes, may mitigate issues prevalent in the digital economy taking into account their implementation timescale. These include in particular the issues associated with transfer-pricing and base-eroding IP profit shifting and income mobility associated with the digital economy:

- BEPS Actions 2, 3 and 4, the recommendations on CFCs and the enactment of ATAD/ ATAD 2;[4]
- BEPS Actions 8-10 on transfer-pricing and the revised DEMPE approach;[5]
- EU's Dispute Resolution Directive as a follow-up of BEPS Action 14;[6]
- Directive on CbCR as follow-up of BEPS Action 13.[7]

ATAD in particular is key legislation to protect the tax base among EU Member states against tax avoidance practices and to ensure tax is paid where the profits are generated, which, once implemented, shall end some of the existing mismatches that cause market fragmentations and distortions. Equally, the mandatory introduction of CFC rules per ATAD addresses some of the issues associated with transfer-pricing and the base-eroding IP profit shifting and income mobility prevalent in the digital economy.

Similarly, the revised OECD Transfer-Pricing Guidelines alongside the revisited PE concept per BEPS Action 7 address other relevant BEPS concerns associated with the digital economy:

- The reduced dependent agent threshold, where implemented with applicable MLI provisions (Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting), reduces "under-taxation" opportunities for digital businesses in jurisdictions where the customers are located;
- Anti-fragmentation rules regarding specific activity exemption address further issues: what formerly constituted mere preparatory or auxiliary activity would now be within the PE threshold, ie. shall constitute taxable presence in the source jurisdiction.

[4] Council Directive (EU) 2016/1164 of 20 June 2016 laying down rules against tax avoidance practices that directly effect the functioning of the internal market, and, Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries

[5] Revised OECD approach related to development, enhancement, maintenance, protection and exploitation of intangibles, BEPS Actions 8–10 on transfer-pricing aspects of intangibles ('Aligning Transfer Pricing Outcomes with Value Creation'), 5 October 2015

[6] Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union, which CFE welcomed in its Opinion Statement of 23 May 2017 as a means of improved mechanisms available to Member states to resolve double taxation disputes: http://taxadviserseurope.org/blog/portfolio-items/opinion-statement-fc-4-2017-on-the-proposed-directive-on-double-taxation-dispute-resolution-mechanisms-in-the-european-union/

[7] Council Directive (EU) 2016/881 of 25 May 2016, which amends Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation ("DAC 4")

CFE acknowledges, however, that the BEPS project has not resolved all the issues related to the tax challenges of the digital economy. This presents an exceptional challenge for the policymakers in seeking to address further BEPS issues that arise therefrom, as well as the pertinent issue of addressing the increased reliance of data in "value creation" and B2C sales in host countries from a tax perspective.

Further, CFE believes that in absence of international tax policy consensus on the features of the various business models in the digital economy, the digitalising traditional business models as well as a concurrent review of the 'nexus' and 'profit allocation' concepts, unilateral actions on taxation of the digital economy could compound existing shortcomings and aggravate competiveness and growth risks in the Single Market. Accordingly, interim measures on taxation of the digital economy need to be introduced with caution, weighing the expected revenue from this tax against the potentially adverse impact.

## 3. Comprehensive identification of the features of digital business models

The academic and policy discussions related to the concept of "value creation" and "profit attribution" in the digital economy indicate an absence of international consensus on such a definition for tax policy purposes. Similarly, the OECD work on identifying the scope of the business models in the digital economy is ongoing and the Interim Report of March 2018 indicates that it will take more time to pinpoint the features of both the digital business models and the digitalising traditional ones.[8]

The proposed EU directive recognises that a fundamental principle for profit allocation should remain that taxation takes place in the jurisdiction where value is created. Thus, a globally accepted definition on what constitutes value, where is the value created, and how it is apportioned for tax purposes is lacking. The evolving nature of the digital business models and the digitalising traditional business models merit a proper evaluation, which is currently being undertaken by the OECD. This process is also carried out by the EU with the revised rules on profit attribution or a revised concept of PE in the context of the proposed Directive on Significant Digital Presence and the related Tax Treaty Recommendations.

In this vein, CFE supports the work that seeks to explore the extent to which the new forms of business activity generate value and how will such value be attributed among jurisdictions for taxation purposes.

[8] Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing (2018), Paris, http://dx.doi.org/10.1787/9789264293083-en.

## 4. Arrangements within scope of the proposed Directive

At present, the following arrangements are within scope of the Commission proposal:

- *Advertising*: the making available on a 'digital interface' of advertising space for advertising that is aimed at users of that interface;
- *Multilateral interfaces*: the making available to users of a 'digital interface' which allows users to find other users and to interact with them, and which may also facilitate the provision of underlying supplies of goods or services directly between users; and,
- *Selling of user data*: the transmission of data collected about users and generated from users' activities on digital interfaces.

CFE considers that it is vital to arrive at a common understanding of the features of the emerging business models in the digital economy and subsequently to determine what constitutes "value" for tax purposes. Digital business models continue to evolve with the utilisation of emerging technologies, such as artificial intelligence and block-chain, or leverage on the use of data and user relationships with platforms. Identifying relevant business model features is clearly a prerequisite for an adequate policy solution. Only once key contributing factors have been identified will it be possible to develop consistent policy proposals in line with the Ottawa principles.

In CFE's view, EU's focus on long-term solutions as opposed to the interim taxation will avoid a perception that such taxation creates arbitrary distinctions between different business models and consequently the arrangements within scope.

## 5. Methodological choices on the arrangements within scope

In our view, the argument that certain models are within scope of the Directive on digital service tax due to 'more significant user contribution'[9], whilst others are not, could be perceived as amounting to a distinction within digital business models. Encompassing or leaving out of the scope of the EU proposal certain digital business models or particular elements of certain digital business models could potentially raise WTO-related issues too.[10] The dependence on user involvement and the monetisation of user participation is indeed a distinct

[9] Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services of 21.3.2018 COM(2018)148, at page [4]
[10] *idem*, Article 3

feature of the digital economy that merits a comprehensive understanding and evaluation, as a matter of international tax policy.

# 6. Discrimination, Double Taxation and Tax Relief

## 6.1. Tax Relief and Double Taxation

The proposal contemplates deductibility of the new tax from the Corporate Income Tax base, irrespective of whether tax is paid in the same or another Member state. A key policy consideration in a situation where a tax is not a covered tax for double tax treaty purposes is the inability of a taxpayer to claim double taxation relief.

Considering that turnover taxes are substantially similar to VAT, these do not qualify as income taxes, which consequently excludes the possibility for treaty relief in the resident jurisdiction of the taxpayer. It is widely accepted in academic literature that turnover taxes such as the one proposed by the Commission do not fall within the scope of the OECD Model Tax Convention and double tax treaties.[11]

If a tax is not a 'covered tax' under Article 2 of the OECD Model, it would consequently not be covered by either the 'distributive' articles of the OECD Model, nor would it qualify for dispute resolution under MAP (Article 25 of the OECD Model). Accordingly, such indirect taxes would not qualify for relief from double taxation under Article 23 of the OECD Model in the residence jurisdiction of the taxpayer, and will involve double or multiple taxation.

## 6.2. Discrimination of non-resident entities

The design of any interim measures should not result in discrimination of non-resident businesses. The proposals need to ensure that the tax does not covertly differentiate between resident and non-resident entities that are in a comparable factual and legal situation, taking into account existing obligations under WTO and State Aid rules. CFE understands that this is not the intended policy outcome, hence the detail should meet Commission's policy intention.

[11] In such a scenario, relief for taxpayers will be limited to unilateral measures, if available, in absence of treaty relief. Philip Baker QC, International Tax Law and Double Taxation Conventions, Sweet & Maxwell (2017), at 2B.10.

## 7. Sunset clause

Interim measures should clearly reflect their temporary nature. Consequently, such measures should cease to apply either once a global solution has been agreed under the G20/ OECD auspices, or, alternatively, once the Directive on significant digital presence enters into effect.

In this vein, consideration should be given to the policy intention that companies may cease to be subject to interim taxation only when they become subject to tax under the Directive on significant digital presence. This follows on from the fact that the Directive on significant digital presence is tied-in with a Recommendation to amend tax treaties with third countries, which may or may not occur in due course. It transpires from the design of the proposals that the interim Digital Services Tax will become permanent taxation for the companies that are not subject to the Directive on Significant Digital Presence.

This policy intention seems to be at variance with the recommendations of the OECD Interim Report on temporary limitation of any interim measures on taxation of the digital economy, taken by particular countries individually or collectively at regional level, such as in the EU context.[12]

## 8. Economical distortion and tax cascading

The CFE appreciates the narrow scope of the proposal by the inclusion of two revenue-related thresholds. Our view is that other safe harbours, such as a profitability threshold, may need to be considered in order to minimise the impact on companies with low profitability. Principally, gross revenue taxes significantly affect companies with small profit margins. Contrary to the common objectives, a wrong message may be conveyed as a matter of policy to the nascent European digital sector, which may also discourage outsourcing and, as a consequence, the efficient utilisation of resources.

Further, it is widely recognised that turnover tax levied on gross revenues with no deduction of costs is economically distortive, with the incidence falling on the final consumers. Turnover taxes were replaced with VAT due to the impossibility to credit against a Corporate Income Tax base and the related issue of tax cascading. In absence of the right of deduction, distortive consequences of the cascading effect of such taxation has led to the abandoning of this system and introduction of VAT in the Single Market decades ago.

[12] Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing (2018), Paris, para 432 at page [184]

## 9. Viability of the One-Stop-Shop & Capacity issues

CFE welcomes the simplicity that the "One-Stop-Shop" will provide for the taxpayers and administrations affected by this proposals. We are worried however that the existing capacity issues with the VAT Mini-One-Stop-Shop (MOSS) may be compounded by the administrative obligations set out in the proposal for a Directive on DST. The MOSS, as conceived for use in the VAT area, is set to become available to all taxable persons in the form of One-Stop-Shop (OSS), and serve as a 'clearing house', whereby Member states would transfer a portion of the DST to other member states where the tax is legally due.[13]

Similarly, there may be confusion arising from the mismatching definition of tax residency for corporate tax and DST purposes.[14] The CFE accepts that this distinction stems from the different basis of these taxes (income tax versus turnover tax), however, further detail may be necessary for reasons of clarity.

We strongly agree that taxpayers should not be liable to fulfil administrative obligations in different Member states where they are 'resident' for DST purposes, but equally, the practical difficulties and capacity issues of the OSS need to be taken into account.

## 10. Dispute Resolution

CFE envisages an increase of tax disputes related to the implementation of the Digital Services Tax. Tax tribunals operate at limit of capacity in many European countries, whereas the EU Dispute Resolution Directive/ the Mutual Agreement Procedure ("MAP") is applicable to direct taxes only. Consequently, the issue of which forum shall deal with such disputes in the EU context is raised alongside potentially increased costs of doing business.

The experience of CFE members concurs with the findings set out in the impact assessment of the Dispute Resolution Directive.[15] The limited scope of the EU Arbitration Convention and Article 25 of the OECD Model Tax Convention results in the inability of taxpayers to invoke and rely on such procedures, and is compounded by the lengthy and often ineffective conclusion of dispute resolution procedures. This is equally applicable at present to the arrangements within scope of the proposed directive on Digital Services Tax.

[13] Articles 9 – 19 of the Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services of 21.3.2018 COM(2018)148
[14] idem, Article 10
[15] Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union

CFE therefore encourages and welcomes any measures that expand the scope of dispute resolution mechanisms to cover new forms of taxation that empower taxpayers' involvement within the process, and are focused on mandatory resolution of the disputes within a fixed time-frame. Consequently, an amendment of the EU Dispute-Resolution Directive to include newly introduced taxes such as the Digital Services Tax may need to be considered.

## 11. Concluding remarks

CFE supports the ongoing process of reaching a globally acceptable solution for the tax challenges of the digital economy. We also acknowledge that the preferred solution of the EU Commission is arriving at a common position on taxation of the digital economy, in absence of which a plethora of uncoordinated national measures throughout Europe could follow, potentially creating further opportunities for tax arbitrage.

CFE strongly believes that the EU should focus on long-term solutions that seek to complement the OECD work on the tax challenges of the digital economy. Accordingly, any interim measures on taxation of the digital economy need to be considered with caution, weighing the expected revenue from this tax against the potentially adverse impact as highlighted in this position paper.

CFE believes that establishing tax certainty in the international taxation framework as well as the protection of taxpayers' rights is of utmost importance and must be a priority for policymakers. Whilst we appreciate the initiatives of the Commission, prospective solutions for taxation of the digital economy need to avoid double or multiple taxation and avoid discrimination of non-resident businesses. Equally, any new taxes need to be within the ambit of existing double tax treaties yet provide access to effective dispute resolution mechanisms.

## *About CFE Tax Advisers Europe*

CFE Tax Advisers Europe is a Brussels-based umbrella association representing the European tax advisers. Founded in 1959, CFE brings together 30 national organisations from 24 European countries, representing more than 200,000 tax advisers.

CFE's role and mission is to:
- Safeguard the professional interests of tax advisers and assure the quality of tax services provided by tax advisers;
- Exchange information about national tax laws and contribute to the co-ordination and development of tax policy in Europe;
- Maintain relations with the European institutions, the OECD and other international and national bodies, and share with the European Union institutions the tax technical experience and insight of our members from all areas of taxation;
- Seek to provide the best possible conditions for tax advisers to carry out their profession;
- Inform the general public about the role, mission and the services that tax advisers provide.