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European Commission
Rue de la Loi / Wetstraat 200
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Sent via upload

Brussels, 22 December 2017

Subject: EBIT response to the European Commission's public consultation on "fair taxation of the digital economy"

Dear Commissioner,

EBIT is grateful for this opportunity to further comment on the European Commission's e-Survey / public consultation entitled: "Fair Taxation of the Digital Economy", running from 26 October 2017 to 3 January 2018, by way of this accompanying position paper.

EBIT has previously responded to the OECD's work in this area, submitting a response to the OECD Discussion Draft on BEPS ACTION 1: "Address the Tax Challenges of the Digital Economy" published in March 2014[1], and EBIT's views have not fundamentally changed.

EBIT's Members at the time of this submission: AIRBUS GROUP, BP, CATERPILLAR, CONSTELLATION BRANDS, DEUTSCHE LUFTHANSA, DIAGEO, GSK, HUAWEI, INFORMA GROUP, INTERNATIONAL PAPER, JTI, NASPERS, PEPSICO, PFIZER, RELX, SCHRODERS, SHV GROUP, TUPPERWARE & UTC.

EBIT Key Messages - Taxation of the Digital Economy

Importance of the 'Digital Economy'

- The evolution of the digitalizing economy has been spectacular and we are now witnessing a paradigm shift in taxation in real-time. Business models and value chains are changing fundamentally and value creation is becoming increasingly independent of (physical) activities and physical presence in a market. The new digital economy and business models are disruptive and different. This also profoundly influences the public debate on the tax challenges they pose.

- EBIT welcomes that the EU's and the OECD's policy-makers fully recognize that the digital economy is a powerful catalyst for innovation, growth and social prosperity. For instance, most recently, the ECOFIN Council of 5 December 2017 reiterated that: *"Digitalization has acted as a facilitator and accelerator of cross-border trade and*

[1] http://www.ebit-businesstax.com/pdf/pwc-ebit-comments-on-the-oecd-discussion-april-2014.pdf

affects to varying degrees the whole economy through advanced technological solutions such as cloud computing, big data, robotics, or high speed broadband."

- For business to provide the sustained economic growth needed to meet these ambitions, the vision of Europe's political leaders needs to be turned into realistic and achievable objectives – and into actions. Business cannot make a significant contribution to realizing this ambition if tax systems inhibit modernization.

- Now is the time to address the remaining challenge to ensure that international tax rules are suitable for both the digital and more traditional sectors of the economy. Tax policies can act as a stimulating factor or act as a significant restraint on the digital transformation, and it is therefore crucially important to 'get it right' and to ensure that all businesses operate under comparable conditions for growing and developing, globally and within the EU's Single Market.

- Digitalization has changed value chains within multinational enterprises (MNEs) and raises new questions about where value is generated. How these new value chains will run through different legal entities and countries will change also the tax analysis. We urge the EU and OECD and national policymakers to be diligent and commit to sufficient detailed thought and analysis of the issues identified, and to resist the lure of adopting any intermediate, short term solutions before a comprehensive global solution is agreed. Imposing extra taxes as part of quick, short-term temporary fixes, for instance and in particular, withholding taxes and equalization levies, at national or EU level, carries a significant risk of double taxation, increased disputes and controversy, and inhibiting growth and innovation and risk taking by businesses - if not well-thought out.

- Having said that, EBIT's Members do wish to call to action policy-makers and we reiterate that there is a great shared sense of urgency amongst MNEs for the level playing field internationally to be safeguarded. The conclusion reached in the Digitizing Europe May 2016 report that: "*Europe is at a digital crossroads, with a unique chance to either capture an immense opportunity, or see the region fall behind other nations*" provides a compelling case.[2]

The Digital Economy: Part of the Broader New Economy

- As we already stated in April 2014, EBIT's Members strongly believe that ring-fencing the digital economy as a separate sector and applying tax rules on that basis would be neither appropriate nor feasible, also given the different levels of digitization of businesses we are seeing today. It will therefore be important for business that the neutrality principle is satisfied for any of the EU's or globally (G20/OECD) proposed potential solutions. The tax challenges which the digital economy has raised must apply equally to all businesses and must also not give rise to multiple tax charges.

- Tackling the tax challenges of the increasingly digitalized world is best agreed by international consensus to ensure feasible and practical outcomes and sustainable progress in modernizing the international tax system. EBIT welcomes the EU's ECOFIN December 2017 conclusion underlining the: "importance and leading role of the OECD's current examination of value creation and profit generation processes by the digital economy with the aim to design adequate policy responses."

- What businesses need is a sensible, internationally agreed approach on digital. Unilateral, interim-actions, at EU or national levels, will in our view only impose a further administrative burden and cost on businesses, create less legal certainty and

[2] Digitizing Europe, May 2016 http://image-src.bcg.com/BCG_COM/BCG-Digitizing-Europe-May-2016_tcm22-36552.pdf p. 4

lead to double and multiple business taxation. That scenario may foster concerns about the EU as a growth-friendly region and its attractiveness as a place to invest in.

- It will therefore be essential for any measures agreed amongst the EU Member States to be consistent with any proposals from the OECD. The EU should implement international initiatives at the same pace and to the same extent as its global partners in order to ensure a level playing field. In EBIT's view, action at EU level is only an option of last resort when the international consensus approach has been totally exhausted and not come to any meaningful modernization of the international tax system to deal with digital. Nor are we in favor of a patchwork of national initiatives. Member States naturally take a close interest in any external proposals that could affect their powers to levy tax. However they have a shared interest in operating efficient and effective tax policy and administration in the EU, which will encourage economic growth and enable Europe's businesses and governments better to respond to the changing global environment.

Digital Post-BEPS

- The exponential growth of the digital economy has impacted profoundly on the international tax system and created a number of new tax challenges. EBIT's Members consider that many of these tax challenges are at the moment directly or indirectly being addressed by OECD BEPS, i.e. via the international consensus driven process. The OECD's report on BEPS Action 13 for instance acknowledges that the digital economy does not generate unique BEPS issues but that some of the key features do have the propensity to amplify BEPS-related risks.

- EBIT Members anticipate that the OECD BEPS actions should substantially mitigate the effect of mismatches and remaining loopholes in the international tax system. In our view it is therefore premature to judge the OECD BEPS package measures as inadequate, since all EU jurisdictions are still in the process of implementing the BEPS recommendations into their national legislation. Until BEPS and ATAD I and II, and new indirect tax (VAT/GST) measures have been duly implemented within the EU it is hard to determine what other measures (if any) are necessary to tackle the tax challenges of the digital economy. EBIT Members consider it unwise to introduce several regional targeted, temporary solutions onto the OECD's BEPS recommendations that have been committed to and are currently being adopted and implemented by countries, without a diligent and sufficient impact analysis.

The Commission's Proposed Alternative Approaches

- The Commission's e-Survey mentions that several targeted, temporary solutions have been identified to solve the current problems related to the international taxation rules for the digital economy. However, EBIT's Members do not favor a two-step approach as has been proposed by the Commission. To us day-to-day tax practitioners the proposed solutions are impractical and may be inconsistent with the international treaty framework. With regard to any long term, comprehensive solutions to solve the current problems related to the international taxation rules for the digital economy proposed by the Commission, other solutions could be analyzed such as a modified EU CCCTB proposal, i.e. the common corporate tax base but with consolidation. However, the impacts of this potential long term solution should be reviewed in more detail.

- The Commission's September 2017 Communication and e-Survey of end of October 2017 set out three options to address the broader direct tax policy challenges of the digital economy, on which EBIT Members wish to briefly comment below.

    - *"**Equalization tax on turnover of digitalized companies** - A tax on all untaxed or insufficiently taxed income generated from all internet-based* *business activities, including B2B and B2C, creditable against the corporate income tax or as a separate tax."*

A digital equalization levy based solely on customer numbers in the market country does not sit well with the OECD BEPS project's quintessential principle of taxing profits where value is created. In our view this would lead to a separate taxation for so-called digitalized businesses / digital companies, so it will not respect the neutrality principle alluded to above already, which is critical for MNEs. A new definition would be required of a 'digital business' or 'digital company' for the purposes of the new levy's scope of application. EBIT does not think that such a levy would be creditable under existing OECD double tax treaties, hence this would likely result in double and multiple taxation of business profits.

- *"**Withholding tax on digital transactions** - A standalone gross-basis final withholding tax on certain payments made to non-resident providers of goods and services ordered online."*

  This option moves away from the trend in previous years in international taxation which was based on an international consensus to minimize or eliminate withholding taxes because taxes imposed on gross income do not take into account profitability and making cross-border expansion unprofitable. Imposing a new withholding tax could also mean that many non-digital or conventional businesses would become subject to withholding tax on digital products designed for a specifically targeted industry. EBIT would like to know which payments would become subject to tax and which rates would apply, and whether these decisions would be taken at local or international level.

  EBIT is also concerned about the collection and enforcement issues for tax authorities related to the possible introduction of a myriad of domestic withholding taxes. It is also unclear to us how this would work in practice: is the idea to introduce for instance a withholding agent for the taxpayer? Such a withholding tax on certain types of digital transactions would also miss every connection with the jurisdiction where value is created and would also come very close to a sales tax. In EBIT's view, both the withholding taxes and equalization levy options will not only result in double or multiple taxation but are also likely to seriously reduce the potential of the digital economy to deliver economic growth.

- *"**Levy on revenues generated from the provision of digital services or advertising activity** - A separate levy could be applied to all transactions concluded remotely with in-country customers where a non-resident entity has a significant economic presence."*

  EBIT believes that it may be reasonable to revisit the borderline between what is to count as crossing the PE threshold rule and what is treated as not creating tax nexus for the purposes of the rule given the potential to operate in the market of another State without or with hardly any physical presence. However, EBIT considers that the variations of the proposed changes by the OECD to the exemptions of PE status for various items of a preparatory or auxiliary nature (Article 5, paragraph 4 of the Model Convention) suggested, are relevant to some (but probably a limited number of) digital businesses, but may potentially have a more significant impact on wider businesses, which does not seem an even-handed approach to the issue.

  With regard to the concept of "virtual PE", EBIT notes that the EU and OECD seem to effectively be presenting a new nexus band / PE threshold concept but leave open the difficult related and contentious questions as to how to attribute profits to a PE and value to data. It will be extremely challenging to try to attribute a PE nexus to a business that only has a presence in a state through for instance mere data. If all the people functions in extracting the value from that data are located elsewhere EBIT wonders what value is to be attributed to that data.

Departing from the functional analysis (based on functions, assets and risks of the taxpayer) would have fundamental ramifications and require wholly new -tax neutral- models for income attribution. However, for some of EBIT's Members, the digitalization of certain elements within the supply chain has not created significant tax challenges. We consider that the other OECD BEPS Actions have provided sufficient clarity on around the taxation of the business profits, namely that profits should be taxed in the jurisdiction where the value has been created and that profits are created through the operations of specific people functions. So a distinction needs to be made in EBIT's view between the direct tax policy challenges of the modernizing economy and allocation of taxing rights from concerns of non-taxation. Taxing profits according to the value chain of a product or service should still be fair in a modern market, as the jurisdictions in the value chain where the value is created should continue to have taxing rights on the generation of profits.

Finally, tax administrations are likely to interpret "significant economic presence" very differently - even if international consensus is reached on a definition. This is likely to result in uncertainty for businesses and a risk of a steep rise in international tax disputes and tax controversy.

Digitalization and Different Business Models

- More MNEs than ever are actually operating a number of distinct business models within their own businesses. Any new tax policy design or additional taxation mechanisms will need to do justice to and respect the variety of digital business models that exist today.

Modernization of Tax Administration

- EBIT is convinced that modernization of tax policy will help to create an environment in which business can comply more easily with tax regulations and enable them to concentrate on sustainable growth, investing in people and innovation. Such modernization is also essential for maintaining the EU's position in an increasingly competitive world. The modernization and digital transformation of tax administration would benefit both governments and business. Businesses should be able to embrace the benefits of new technology without tax rules creating unnecessary hurdles. A consistent approach to tax administration across the EU, and for different taxes, would lead to greater efficiency for government and reduce distortions between EU Member States. Transparent, simplified and certain administrative practices on an EU-wide basis would allow businesses to operate in a free and open tax environment. It would make their work in complying with their tax obligations, and that of tax authorities in monitoring compliance, easier and more efficient.

EBIT trusts that the above comments are helpful and taken into account by the EU and the OECD in their work towards the much needed international consensus on this subject. EBIT is always happy and open to discuss with all relevant stakeholders.

Yours sincerely,

European Business Initiative on Taxation – December 2017

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