Pierre Moscovici
Commissioner for Taxation
European Commission
Belgium

Sent via upload

Brussels, 3 January 2018

Subject: Public Consultation - Fair taxation of the digital economy

Dear Commissioner,

1. Accountancy Europe is pleased to comment on the European Commission's public consultation '*Fair taxation of the digital economy*'. This letter provides additional context for our response to the public consultation, with which it should be read in conjunction.

Executive summary:

- **The digitalised economy** – the issues identified in the public consultation are not always specific to the digitalised economy, which cannot be ringfenced from the economy as a whole.
- **Temporary measures** – we do not agree with the imposition of temporary measures and believe that the Commission should prioritise the development of a long-term solution, agreed at international level.
- **Long-term, comprehensive measures** – we believe that the long-term solution is to agree and implement as soon as possible an internationally agreed Virtual Permanent Establishment.
- **Smaller entities** – if temporary measures were to be introduced, we believe that these should apply only to the very largest businesses.

THE DIGITALISED ECONOMY

2. The global economy is becoming increasingly digitalised. Therefore, it is legitimate to question whether the current international tax frameworks are sufficiently equipped to deal with challenges of a digitised international economy, particularly as it poses many challenges to the sustainability of public finances and increase public concerns on the fairness and effectiveness of the tax system.

3. Many countries have refashioned their tax systems in recent years, not least to recognise the difficulty of identifying and taxing profits. This has increased the taxation of, for instance, labour, property and sales (VAT), and is reflected by the total tax contribution made by corporations. However, this has not diminished the perception that international businesses – not just digital ones - are in a better position to take advantage of deficiencies in the existing tax regime to pay less tax than their purely domestically based competitors.

4. We do not agree with the supposition in *Section 4, Current Problems* of the public consultation that the misalignment between taxation and value creation is a particular characteristic of the digitalised economy.

5. Globalisation has made it increasingly difficult to identify where value is created in a global supply chain. This is exacerbated by unfair tax competition conducted by some jurisdictions for the benefit of businesses with mobile assets. Digitalisation has magnified these existing structural issues in tax systems, by facilitating cross border trade and market dominance by innovators.

6. Consequently, we believe that the issues addressed by the public consultation are not unique to the digitalised economy and that it is not possible to separate the digitalised economy from conventional businesses. This view has already been expressed in the OECD's BEPS Action 1 paper and in the report prepared by the Commission's own Expert Group on Taxation of the Digital Economy.

7. Moreover, digitalised businesses are not homogenous and do not operate the same business model. Additionally, many of these companies have multiple business models -some of which are 'old economy' models (such as the manufacture of consumer devices or the sale of products) and others are digitalised economy models (such as cloud storage and the provision of software as a service). As such, there is no single easy solution that can be uniformly applied across these companies or across the business models of individual companies.

8. However, there is a legitimate concern that some aspects of the digitalised business models are currently not properly taxed. This is the case particularly for the value of collected data (both as part of a primary and subsidiary business model) and where the taxing rights for this value creation should be allocated.

9. Therefore, we have answered '*to some extent*' for question 4.1. There are some specific taxation issues – mostly relating to data – that do need to be addressed. However, many of the issues in respect of fair taxation of the digitalised economy will be addressed by the implementation of the BEPS measures. It is also likely that reform of corporation tax in the United States will result in the collection of much of the untaxed income that is currently the source of public concern.

TEMPORARY MEASURES

10. *Section 5, Possible Solutions* of the public consultation starts by proposing a two-stage approach. We acknowledge the public concerns about apparent non-taxation of certain high-profile companies and the need for governments to respond to these concerns. However, we do not support the imposition of temporary solutions introduced without sufficient analysis of their potential impact on the international tax environment.

11. Some governments have already introduced national legislation to assert taxing rights over profits that they believe to have been created in their jurisdictions. Some of these measures are incompatible with existing international tax treaties and will probably result in double taxation for affected companies. For this reason, we do not support unilateral action at a national level. We call on national governments not to undermine the international tax system or the positive international tax cooperation achieved in past years.

12. Value creation and taxing rights in the digitalised economy are both complex and global issues. We call for the OECD and other interested parties to complete their analysis and seek international agreement on the best solution as soon as possible to allay public concerns over loss of tax revenue.

13. We believe that there should not be any measures introduced at the EU level until after OECD's Task Force on the Digital Economy has reported its findings. With 108 different countries involved in this project, it is the best hope for a long-lasting solution with the least risk of substantial and unpredictable double taxation.

14. A long-term EU approach would still be suboptimal compared to an internationally agreed approach but is still preferable to a plethora of overlapping and potentially conflicting national initiatives.

15. However, an additional issue arises with EU **temporary** tax legislation as the EU's legislative process requiring unanimity makes such temporary legislation difficult to repeal. It is easier for individual Member States to repeal national temporary legislation. Therefore, if the EU were to adopt temporary measures without departing from its commitment to a global solution, we believe that a sunset clause (specifying the date of the legislation's withdrawal) would be absolutely necessary.

16. Also in respect of temporary measures, there has been insufficient time to evaluate the impact of the OECD's BEPS project and the related EU Anti-Tax Avoidance Directive. We believe that many of the public concerns about the non-taxation of certain MNEs will be addressed by these initiatives.

17. Temporary measures are also likely to take considerable time and cost for both national legislators and businesses to implement. Moreover, in our experience temporary measures risk becoming permanent ones, once implemented. In turn, this risks further fragmentation of the international tax system and increased double taxation.

18. In respect of the specific temporary solutions presented in question 5.2 of the public consultation questionnaire, we do not believe that sufficient detail has been provided to permit us to make a detailed analysis of each option. However, we make some general observations below.

DEFINING DIGITAL ACTIVITIES

19. In practice, it will be extremely difficult to define *'digital activities'*, either on the basis of the product or service provided, or by the means by which the service or product is provided. Equally, it will be difficult to separate *'certain digital services'* from the diverse and highly interlinked business models of the companies targeted by these measures.

20. Consequently, it is highly probable that any 'digital tax' will affect many different businesses, including those in more traditional sectors based in higher tax jurisdictions. Such businesses would be even more affected by potential double taxation than pure digital business operators that are able to route their operations through low tax jurisdictions.

WITHHOLDING TAX

21. A withholding tax implies the prepayment of an amount that will be taken into account when the final tax liability is due. However, there will be situations where no corporate income tax is due - either because profits are not being made or because there is no equivalent base tax against which to offset the tax withheld. In these circumstances, the withholding tax would become an additional tax burden in its own right. International companies may be subject to corporate income tax in other jurisdictions on the same income and the withholding tax paid may not be creditable against corporate income tax under existing double tax treaties. In such a circumstance, double taxation will occur.

TURNOVER BASED TAX OR LEVY

22. From a systems point of view, turnover based taxes are easier to pass directly on to the consumer than taxes based on profit. This increases the cost for the consumer without addressing the underlying issue of whether a fair level of tax is being paid by the businesses in question.

23. Taxes based on turnover rather than profits must be very carefully designed if they are not to disadvantage small businesses, particularly start-up or rapidly growing businesses. Current corporate income taxes generally require that profits are generated before tax is charged – a turnover based tax that could not be passed on to consumers would result in a tax charge even where the business is making losses. This is particularly problematic for innovative digital businesses, where it may take many years before profits are generated and where new products are often released before they are fully monetised.

24. Turnover based taxes can also lead to a cascade effect, whereby the cost base of the product (goods or services) is increased at every stage of the value creation process, especially if that process involves cross-border supply chains. This would then increase the cost of products in services within the EU and make EU exports less competitive.

LONG TERM, COMPREHENSIVE MEASURES

25. Of all the long-term options presented in question 5.4 of the public consultation questionnaire, we believe that the proposal for a *Digital presence in the EU* could be a viable solution, albeit with significant provisos.

26. We do not believe that the current basis of allocating taxing rights based on value creation is fundamentally broken. However, it does require adjustments to deal with issues such as double non-taxation (already addressed in the OECD's BEPS project), value creation for specific digital models and the allocation of taxing rights between countries.

27. However, as the digitalised economy cannot be ringfenced from the broader economy, these aspects need to be examined for all businesses and not just those with highly digitalised business models.

28. Consequently, we believe that any EU proposal should be aligned with the OECD's work on a Virtual Permanent Establishment. This would ensure that there is a level playing field between different businesses and, with international cooperation and agreement, a reduced risk of harmful double taxation.

SMALLER ENTITIES

29. Tax legislation should only be enacted after a full impact assessment covering businesses of all sectors and of all sizes has been conducted. As far as possible, legislation should be proportionate and not have unintended consequences.

30. A well-designed long-term solution should not, in principle, require a carve-out for smaller entities. However, if any temporary solutions were to be enacted, including those proposed in this public consultation, a temporary carve out for smaller entities would be necessary to ensure the competitiveness of the European market for innovative businesses.

31. As mentioned above, some of the proposals – for example, turnover based taxes – could have very adverse effects on smaller businesses, especially if they are in a start-up phase with limited capital reserves or are undergoing a significant increase in sales.

32. However, aligning the scope of the temporary measures with that contained in both the ATAD and the proposal for public country by country reporting of tax information – i.e. only MNEs with turnover exceeding €750 million – would address the main concerns of legislators and the public whilst reducing the harmful impact of double taxation on EU businesses.

ISSUES WITH THE PUBLIC CONSULTATION FORMAT

33. We find the format of this consultation to be unsuitable for such a complex issue. Particularly, it is very difficult to give a considered response to a range of proposals with the limited level of background information provided in this consultation.

34. We also believe that the scope of the consultation is too broad for the current state of the proposals. For example, we have answered *neutral* across the board for questions 5.6 and 5.7. Without knowing exactly what measures are being considered and with insufficient detail of the measures, it is impossible to assess their impact for both taxpayers and tax administrations.

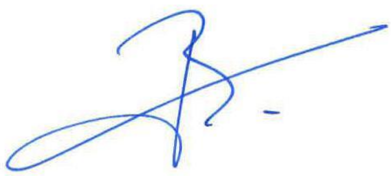
35. We also find questions such as 4.10, which require an arbitrary ranking of desirable yet sometimes conflicting objectives\statements, to be superfluous to the main issues being addressed.

36. Furthermore, we feel that the provided deadline – 3 January – is insufficient for dealing with such a complex matter. Instead of the usual 12-week consultation period, the Commission has given stakeholders less than 10 weeks. This makes a real difference especially given that the consultation extends over a holiday-period, during which receiving input from our constituents and experts is particularly challenging.

37. Finally, the restriction of additional comments to a maximum of 100 or 200 characters is unnecessarily restrictive. Although there is an option to upload additional documents, restricting the information that can be added to the main questionnaire gives the impression that the Commission is not really looking for considered or well elaborated views on the topic. This impairs the transparency and public engagement that a public consultation should promote.

If you wish to discuss this response in more detail, please contact Paul Gisby at paul@accountancy.europe.eu or on +32 2 89 33 370.

Sincerely,



Edelfried Schneider
President

Olivier Boutellis-Taft
Chief Executive

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