ACCOUNTANCY EUROPE.

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Submitted via email - TFDE@oecd.org

Subject: OECD Public consultation – Addressing the Tax Challenges of the Digitalisation of the Economy

Dear Mr. Bradbury

Accountancy Europe thanks the OECD for the opportunity to provide its views on the challenges of modernising the international tax system to deal with the increasing digitalisation of the world. Please find below Accountancy Europe's comments on the issues and proposals raised in your consultation document.

Accountancy Europe supports international initiatives to reduce the possibility of both double non-taxation and double taxation. We also support the development of international consensus on how to make the international tax system fit for the future - including how new digitalised business models impact the existing tax systems.

Consequently, we support the OECD's initiative in trying to obtain international consensus on how to tax an increasingly digitalised economy – particularly as unilateral measures taken or proposed by national governments and tax authorities increases the risk of double taxation for businesses and threatens the integrity of the international tax system as a whole.

That being said, the lack of detail in the proposals in the consultation document, some unclear terminology and the lack of time given to respond to a very complicated matter has limited the degree to which we have been able to provide a detailed response to the questions asked – although we have followed the layout of the questions where possible. We look forward to being able to contribute further to this important work when more detailed proposals are produced by the OECD.

PILLAR ONE – REVISED PROFIT ALLOCATION AND NEXUS RULES

The OECD is rightly responding to pressure to change the international tax system by attempting to deal in a consensual fashion with developments in the global economy, including new and changing business models facilitated by digitalisation. Since the introduction of the *Inclusive Framework on Base Erosion and Profit Shifting*, the OECD has the best forum to reach international consensus and the

large number of jurisdictions involved will help reduce the possibility that gaps and mismatches remain and that unintended spill-over effects occur.

It is important to recognise that there are several reasons why such changes are being proposed.

Some national governments are pushing for change, and / or introducing unilateral domestic legislation, due to political pressure arising from the perception that some companies, including highly digitalised companies, are not paying a 'fair amount' of tax in any jurisdiction due to tax avoidance.

Other governments are pushing for change because of the perception that companies, including highly digitalised companies, are not paying a fair amount of tax in **their jurisdiction** due to changing business models. This difference is crucial.

We believe that a combination of the OECD's anti-beps ('BEPS') measures, changes to the US tax regime, public pressure and enhanced transparency have reduced the possibilities for Multi-National Entities (MNEs) to minimise their effective global tax rate. With the BEPS measures and the US tax reforms only starting to come into effect, it is difficult to quantify the impacts of the measures, but they are likely to be significant as the OECD and the G20 did a very thorough analysis of the problems inherent in the international tax system, addressing them and securing worldwide implementation.

Consequently, tax avoidance may not be the best driver for making changes of such a fundamental nature as moving the nexus of certain activities or business lines from one jurisdiction to another. A more appropriate driver is ensuring that tax systems correctly capture the value created by all businesses and that, where necessary, new taxation models are developed to ensure a level playing field between highly digitalised businesses and more traditional, local businesses.

Decisions on the division of taxing rights between jurisdictions is a political decision to be agreed upon by sovereign countries in international fora. However, Accountancy Europe as the association of European accountants, would like to outline that any new system needs broad international agreement and should be a long-term solution that is conceptually sound and that provides legal certainty as well as a robust mechanism for swift and cost-efficient dispute resolution – thereby minimising the likelihood of double taxation.

THE THREE PROPOSALS

Businesses can have a footprint in jurisdictions other than their home jurisdictions through the increasing digitalisation of the economy. This was highlighted in the OECD's 2018 *Tax Challenges Arising from Digitalisation - Interim Report*, which identified three characteristics that put the existing international tax architecture under strain:

- cross-jurisdictional scale without mass
- reliance on intangible assets, including intellectual property (IP)
- the increasing importance of data, the impacts of user participation and their synergies with IP

These characteristics are not limited to what are considered to be purely digital businesses but will increasingly permeates through most, if not all, business models.

Currently, B2C businesses are affected more, but it is easy to see that increased user involvement will spread to many B2B transactions and that new ways of monetising digital information will become available to 'traditional' industries. Examples of B2B data include the data provided by automated 'smart' machinery linked to the cloud or aircraft engine manufacturers monitoring the performance of their engines in real-time.

Consequently, an increasing number of business models consist of both a digitalised and a 'traditional' component. Accountancy Europe supports a principles-based approach to the development of a taxation model that encompasses current and future technological developments. Properly developed, this should be capable of applying to businesses of all sizes and in all sectors and thereby provide a level playing field.

For these reasons, we are strongly against measures that attempt to ringfence the digital economy. We also disagree with unilateral, non-consensus, short-term provisions to target 'digital' businesses – such measures are usually designed to be outside the scope of existing double tax treaties. This causes significant double tax issues and associated costs for the businesses affected and threatens to unravel the entire current tax treaty environment.

User Participation

We believe that the first stage is to clearly define the objectives behind proposing the change of nexus. We do not think that combatting tax avoidance is, of itself, a single valid motive for making such changes, as explained above.

As a long-term solution, we don't support the user participation proposal because it ringfences the digital economy, something that many commentators (including the OECD and the European Commission) do not recommend when all parts of the economy are becoming increasingly digitalised. In fact, it ringfences sub-sets of the digital economy, thereby reducing its impact primarily to social media platforms, search engines and online marketplaces, greatly reducing its utility as a long-term solution for broader issues arising from digitalisation.

Also, we tend to agree with the comments made in paragraph 61 of the consultation paper:

"the value created by the contribution and engagement of users does not constitute value created by the business, and instead constitutes value created by third-parties, that are more akin to suppliers than employees, and are remunerated at arm's length through the provision of a free service."

There are some interesting proposals using blockchain to put a value on this input for users, basically providing them with a form of income in a tokenised form. Such a system would also make it easier to locate and measure value creation from user participation within the business concerned. However, this would have an impact on personal taxation and any sort of solution based on this emerging technology would be some years in the future, at least.

Our concerns are predicated on the user participation proposal being a long-term solution. If it were to form the basis of a short-term measure - to be adopted by national governments whilst a suitable long-term proposal is being developed - then our view is more nuanced.

Although Accountancy Europe does not support unilateral measures by national governments targeted at digital businesses, we recognise that a considerable number of jurisdictions are introducing or considering the introduction of such measures. In this context, the user participation proposal has potentially fewer issues than the marketing intangibles and significant economic presence proposals. This is precisely because the user participation proposal only targets undertakings with three specific highly digitalised business models, thereby reducing the potential for spill-over effects into the wider economy. If national governments do introduce such measures, we believe that the OECD should push for a clear commitment that such measures will only be kept in place until a long-term solution has been arrived at by international consensus.

Marketing Intangibles

The marketing intangibles proposal is preferred by Accountancy Europe compared to the user participation proposal because:

1. It does not single out certain types of businesses or business activities but would potentially apply to any business looking to expand its operations outside of its home jurisdiction to access foreign markets

2. It links to an extension of existing internationally accepted transfer pricing rules on intangibles so more obviously sits within the current framework than the user participation proposal

That being said, it has its own issues – particularly the practical difficulties of splitting value creation between trade and marketing intangibles and then further splitting those amongst the different jurisdictions that the entity serves. Further definition of what constitutes marketing intangibles, guidance on how to distinguish these from trade intangibles and elaboration on how to measure the degree to which an undertaking can create a 'favourable attitude in the mind of customers' are required to ensure common interpretations of such concepts in different jurisdictions.

The marketing intangibles proposal is far more fundamental than the user participation proposal and thus will have greater impact – some of it unintended. Without a scope limitation on the size of entity affected, these impacts are likely to impact far more on smaller entities than on MNEs, who will find it easier to restructure to mitigate the impacts and to upgrade their information systems to deal with the requirements. Smaller entities will find it very difficult to get access to the transfer pricing information that would be required under this approach, which would necessitate considerations of introducing thresholds – preferably without creating 'cliff-edge' effects.

Given that the user participation and marketing intangibles proposals share certain characteristics, we support the suggestion in paragraph 63 of the document that consideration of their shared foundations could facilitate the development of a unified approach on value creation. We believe that this is something that could result in a more conceptually sound and less potentially damaging long-term solution but would require much more work from the OECD in further developing the concept.

Significant economic presence

This proposal is a significant change to current permanent establishment rules and therefore requires considerable development and impact assessment to avoid unintended consequences.

It also assumes some form of formulary apportionment for the allocation of profit. Given that there will inevitably be countries that win or lose from such apportionment, getting political agreement on the formula will be extremely difficult - as has been experienced in the European Union proposal for the Common Consolidated Corporate Tax Base (CCCTB).

It is possible that a technically well-designed set of rules for profit allocation on a transactional basis - principles-based and with clear mechanics to avoid double taxation - could have advantages over the marketing intangibles proposal. It is also less likely that smaller entities would be adversely affected by this proposal. However, it is difficult to make detailed comments on this proposal given the lack of detail in the consultation paper and again is an area that would require much more work from the OECD before detailed input could be given.

IMPORTANT DESIGN CONSIDERATIONS

As mentioned, any changes to taxable nexus should be applicable to any business expanding their presence in other jurisdictions. The question should be more a question of how any business uses digitalisation to create value rather than whether specific businesses or business models require different rules. To develop a robust design, the active involvement of those undertakings developing the new business models is essential as this is not simply a question of changing law.

Value creation is not the only concept that needs to be further explored and clearly defined. There are many terms in the public consultation document that are only loosely defined – 'user base', 'platforms', 'marketing intangibles', 'user participation' and 'digital markets' for example – these would need to be further developed to ensure minimising the possibility of unintended consequences and of targeted businesses falling outside the scope.

As mentioned above, a conceptually sound and principles-based solution should be equally applicable to businesses of all size and types. However, we don't believe that the proposals contained in the consultation document have reached that level of development. Consequently, given that some of the proposals could have profound impacts on many businesses, it may be worth restricting its initial scope to only those largest cross-border businesses. This could be achieved by using the €750-million threshold already used in certain OECD anti-BEPs actions and also by the European Union in some of its tax proposals.

It also goes without saying that in the matter of developing any system of profit allocation, losses should be treated similarly as profits.

Regarding the factors used in profit allocation, this is a complex matter that will require significant thought. For example, the factors used in the CCCTB (broadly sales, employee costs and tangible assets) are to some degree 'old economy' and may not accurately reflect how digitalised businesses generate value.

Algorithms and other intangibles greatly enhance the value generated by tangible business infrastructure, particularly in the case of multi-sided platforms. Application of transactional transfer pricing methods are problematic in allocating profits relating to network effects and tendencies towards monopolies. A rigorous and consistent application of the OECD DEMPE (functions relating to development, enhancement, maintenance, protection, and exploitation of intangibles) may conclude

that residual profits should be allocated according to the contributions of these functions but such issues as user participation would need to be added to this analysis.

In respect of such factors as number of active users, numbers of new contracts signed, number of new users generated etc. it will be very difficult to develop fixed thresholds that have relevance in jurisdictions that differ greatly in size and level of economic activity.

METHODS OF ALLOCATING INCOME

We do not have any detailed comments in respect of the various proposed methods of allocating income. The methods proposed are complicated and will require many businesses to invest significantly in their information systems to provide the necessary data for tax authorities.

Without a thorough conceptual framework, the methods for allocating income could easily become arbitrary but still complicated for businesses to apply. With this in mind, perhaps a simpler solution would be to designate a proportion of the global profits of those businesses affected and then allocate them across the countries of consumption on the basis of respective turnover.

If there is a political decision that there is a short-term need for a reallocation of at least some of the income of digitalised businesses to other jurisdictions, whilst a long-term consensus-based solution is being developed, the short-term measures should be time-limited, integrated into the current corporate income tax regime and be as simple as possible for businesses to calculate.

AVOIDING DOUBLE TAXATION AND IMPROVING DISPUTE RESOLUTION

Any change to the current system must be within the aegis of the current corporate income tax system – i.e. it should not be introduced in the form of an indirect tax or levy, as is the case with many of the current national and regional Digital Services Tax proposals. Choosing the indirect tax or levy approach removes the possibility of offset against other corporate income tax paid unless specific changes are made to double tax treaties.

Consideration should also be given to reviewing the impact of the proposals made in the consultation document on other taxes, for example VAT, Goods and Services Tax (GST) and customs duties.

There must also be a mandatory system of dispute resolution to deal with situations where the tax authority of one jurisdiction disagrees with the apportionment and unilaterally increases its share. Without automatic reduction of the profits subject to taxation in the other jurisdictions included in the apportionment, this would lead to double taxation.

We would recommend a system of pre-clearance for such apportionments with a prescribed system for all relevant jurisdictions to give clearance within a set time scale. This would obviously be facilitated by a centralised and automated clearance procedure.

PILLAR TWO – GLOBAL ANTI-BASE EROSION PROPOSAL

Accountancy Europe supports in principle the concept of a minimum tax but recognises the huge issues involved with developing an international framework that can overlay domestic legislation and existing anti-BEPS measures. The US Global Intangible Low-taxed Income (GILTI) shows the complexity of such legislation even when developed purely at a national level.

We are also not convinced that a need has currently been demonstrated at this point. The BEPS actions agreed in 2015 are only now starting to come into force in many countries - most of the European

Union's Anti-Tax Avoidance Directive[1] provisions, for example, will only come into effect from 1 January 2020. It will then take several years for the impacts of changes to become obvious and for an assessment of their effectiveness to be made. We believe that further anti-BEPS measures should be delayed until there is a demonstrated need for their introduction.

This is especially the case as the potential complexity of these rules will require national tax authorities to devote considerable resources into operationalising the rules and to design tax audit procedures to check the filings.

There is a likelihood that such additional measures could have a profound effect on some businesses and some jurisdictions.

Businesses with real economic activities in jurisdictions could be looking at extra taxation because of minimum tax rules, or potentially very costly restructuring. Experience of the GILTI regime is that whilst it has been effective in dealing with MNE's tax structures, extensive modelling is required to deal with its provisions, much of which must be undertaken by smaller businesses that were not initially expecting to be affected by it.

It will also negatively impact on countries that are able to support the economic substance and value creation activities but do not require a substantial corporate income tax base to finance their public spending as it is financed from other taxes and levies paid by businesses and individuals.

We think that it is too early to discuss the detailed technical issues with these proposals – but one obvious issue is the definition of the scope of businesses to be included in such provisions at an international level. For example, using a 25% shareholding or control threshold could easily lead to taxing rights disputes between different jurisdictions and the potential for harmful double tax for businesses, shareholder and pension funds.

A tax on 'base eroding payments' is a significant departure from the arm's length principle and may negatively impact MNEs even though they are able to support the economic substance and value attributable to their transactions. Experiences with, for example, the United Kingdom's 'Diverted Profit Tax' suggest that a consistent and rigorous application of the OECD's post-BEPS transfer pricing guidelines largely negate the need for any tax on 'base eroding payments'. Such a tax should be limited to circumstances without economic substance.

Yours sincerely,

Signed by

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Chief Executive

ABOUT ACCOUNTANCY EUROPE

Accountancy Europe unites 51 professional organisations from 36 countries that represent close to **1 million** professional accountants, auditors and advisors. They make numbers work for people. Accountancy Europe translates their daily experience to inform the public policy debate in Europe and beyond. Accountancy Europe is in the EU Transparency Register (No 4713568401-18)

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[1] COUNCIL DIRECTIVE (EU) 2016/1164 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016L1164&from=EN