ETAF

European Tax Adviser Federation

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Position Paper

of the European Tax Adviser Federation

ETAF

on the

Consultation on the “Fair Taxation Of The Digital Economy”

I. Introduction

The European Tax Adviser Federation (ETAF) welcomes the opportunity to respond to the European Commission's consultation on the "Fair Taxation of the Digital Economy" (hereinafter "the consultation"). ETAF believes that the complexity of the issue at stake requires a more constructive setup than a simple multiple choice survey and we have therefore provided the present document to include additional comments.

II. Preliminary remarks on the digital economy and international tax rules

As highlighted by the Commission on several occasions, the digitalisation of the economy is happening at a very fast pace involving both the digitalisation of so-called "bricks-and-mortar" business models and the activities of highly digitalized ICT companies. Thus, nowadays businesses of all types are using digital technologies in order to easily meet customers and to become more competitive on the market.

The tax framework, on the other hand, was not capable of keeping up with such a quick transformation. As a result, we agree with the European Commission that the current international tax rules need to be adapted in order to tackle these challenges, taking into account the new characteristics of these businesses.

The first aspect to take into account is that a tax policy should be neutral towards taxpayers. The notion of tax neutrality implies that all businesses, despite being local or international, small or large, innovative or not, should bear a similar tax burden. However, taking a look at the digital economy and at digital businesses, their lower tax liabilities are clearly linked to the fact that the international tax rules are outdated.

One of the main issues to be considered is that the existing taxing right of a State on a business is connected with the physical presence of that business in its jurisdiction. However, digital business models heavily rely on intangible properties, which do not require any physical presence to provide services within a given jurisdiction. This situation shows a clear deficiency of the international tax system that undermines the principle of tax neutrality, because the difference between a taxable and a

non-taxable situation simply lies in the fact if the cross-border services provided by the company are of physical or digital nature.

Indeed, under the current tax rules, States are not capable of collecting taxes on the value that some digital companies create on their territories. For example, it is the case of the data on consumers' habits collected by Facebook and then used to sell advertisement through the social network itself.

As a result, the current international tax rules do not permit a fair competition between traditional companies and digital companies. Furthermore, social fairness is impacted, because some digital companies do not pay their fair share of taxes.

Nevertheless, we believe that enacting a different tax treatment for digital companies (meaning here highly digitalised ICT companies that make no use of physical products/services), without considering the digitalisation of "traditional" businesses, could lead to the situation that the Commission loses sight of the global impact of the proposed approaches.

Moreover, it is worth noting that tax challenges related to the digitalisation of the economy are not a unique European problem, but something that is happening at a global scale and that requires a global answer. Thus, it is worth underlining that the OECD is currently working on an interim report on the implications for taxation of digitalisation that should be issued in April 2018. In this framework, the EU seeking to act alone ahead of the OECD may result in a further slowdown of the already weak progresses of the OECD itself and could provoke retaliation measures from other countries such as the US. In contrast, we call on the EU to play a leading role in the field of taxation of the digital economy in the current OECD negotiations, rather than leaving the initiatives with individual Member States in that context.

III. Taxation challenges

Taxation challenges for tax administrations rising from the digital economy are as diverse as the business models flourishing in the digital environment. These business models include online retailers, social networks, collaborative platforms and providers of media services. Each model implies a taxation challenge, but the common root of such challenges is to be identified in the lack of physical presence,

which is the classical tax base according to the current international tax framework. As a matter of fact, physical presence is no longer required in the new digital environment to generate revenues and profits within a given jurisdiction.

The main example of a lack of physical presence generating profits is connected with data. It is clear that digital companies have developed ways to collect, analyse and use data from consumers and that data gathering and data exploitation have radically changed in the last 10 years. Digital businesses gather different types of data and the exploitation of such data is diverse, according to the type of activities carried out by each company. One of the main arguments a State can present for introducing a taxing right on a digital company is connected with the value of the data collected by the company in its jurisdiction. Indeed, the value of such data is relevant for tax purposes in an international tax environment and triggers the question of a taxable presence of a digital business even in absence of a physical presence. However, the main issue with data is determining their value and in particular the value of the raw data collected. Indeed, for accounting purposes, such raw data will not appear on balance sheet of businesses and will not be relevant for calculating profits for tax purposes.

This uncertainty on data for digital companies is linked to the application of transfer pricing and profit attribution principles, resulting in an even greater uncertainty concerning the exact allocation of the value created among different jurisdictions.

Besides data, these new business models rely heavily on highly innovative procedures making use of intangible property (IP) to undertake their activities. The combination of the use of innovative procedures and IP (i.e. brands, patents, algorithms, etc.) permitted new value chain models unlikely to be separated and analysed under the current international tax framework.

As a result of the weakness of the current international tax system, an unfair competition between digital and non-digital economy has emerged. This is mainly related to the more straightforward application of the concept of permanent establishment in the case of a traditional business (due to its physical presence) compared to a digital one. A further level of distortion is observable comparing companies only operating at a national level with multinational groups, where the latter can easily benefit from the abovementioned weaknesses of the current international tax framework.

IV. Comments on proposed solutions

The two-step approach proposed by the European Commission within the consultation to solve the weaknesses of the international tax framework in relation to the digital economy is to be further clarified. First of all, it is not clear how long these so-called temporary solutions should last and whether there is chance for them to evolve into permanent solutions. Furthermore, given the time it takes to reach an agreement on such temporary solutions, we advise the European Commission to undertake a cost-effectiveness analysis to establish if it may be better to concentrate all its efforts on finding long-term solutions instead.

Temporary solutions

It is worth underlining that the temporary solutions mentioned within the consultation are hard to comment due to the lack of details in relation to their actual design and enforcement.

In general, we believe that the introduction of a tax on revenues as proposed in the consultation leads to an increasing bureaucracy for tax administrations and compliance costs for companies (even SMEs, start-ups and loss-making companies if no thresholds are established) without tackling the issue of the nexus between the company and the value created within the taxing jurisdiction. Accordingly, we are concerned that the outcome will be an outburst of tax controversies.

Concerning, the proposed “digital transaction tax”, we should assume, in the lack of further details, that the application of this kind of levy is highly complex due to the intricacy of the value chain of digital companies and the consequent complexity in identifying the segment of the value chain where the value deemed to be taxed is created.

Long-term solutions

As stated with regard to the short-term solutions, it is hard to provide detailed comments on the proposed long-term solutions due to the lack of details.

Generally speaking, the “Digital presence in the EU” proposal needs a clear definition of digital presence. Accordingly, if this new definition of digital presence should imply a modification of the

functions, assets and risks analysis (as internationally recognised and defined by the OECD), then we believe that a profound analysis of the potential impacts not only on taxation but also on growth is needed. Indeed, a step forward through this path leading to different definitions at EU and OECD level could add another layer of complexity for potential investors, discouraging both non-EU businesses from investing within the EU and EU businesses from investing abroad due to the different taxation systems.

ETAF agrees however that the definition of permanent establishment needs a revision taking into account the digital environment. The existing territoriality rules for the concept of permanent establishment are not applicable to numerous transactions resulting from online commerce and digitalised businesses in general. ETAF suggests to complement the current permanent establishment rules with specific provisions for digital transactions. These rules should be linked to the existence of an economic activity within the State of consumption, which is the State where the turnover is generated.

Concerning a destination-based corporate tax and a unitary tax, it is not clear how these kinds of levies bring a connection between the actual value created by a digital company within a jurisdiction and the taxing right of the jurisdiction itself. Again, we believe this could lead to an increase of tax controversies.

Finally, ETAF points out that the introduction of a “Residence tax base with destination tax rate” would impose a system which is contrary to the current EU treaties, where the definition of corporate tax rates falls within the competence of the Member States.

V. Concluding remarks

ETAF highly welcomes the efforts of the European Commission to find a balanced and equitable solution in the taxation of the digital economy. ETAF shares the Commission’s position that the current international tax rules do not permit a fair competition between traditional companies and digital companies. The European Union should absolutely play a leadership role in this process. However, the global dimension of the phenomenon may under no circumstances be disregarded. The solution-finding process should therefore take place within the framework of the OECD.

The central crux point in the discussion is related to the “taxable presence” of a company. As we are only at the beginning of the digitalisation process, the classical “physical presence” of companies will constantly be diminishing. This development is unstoppable and will proceed at a fast pace.

ETAF is in favour of introducing new territoriality rules for e-commerce transactions as a complement to the existing permanent establishment rules. On the basis of these complementary rules, ETAF considers the introduction of a levy on the turnover achieved in the respective country to be a useful measure.