Irish Tax Institute

Position Paper for the European Commission's

Consultation on the Fair Taxation of the Digital Economy

20 December 2017

About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax.

The Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. With over 5,000 members in Ireland, along with the Chartered Institute of Taxation UK and The Tax Institute of Australia, we are part of the 28,000-strong international CTA network and a member of the Confédération Fiscale Européenne, (CFE) the European umbrella body for tax professionals.

Our members provide tax education and expertise to thousands of businesses, multinationals, and individuals in Ireland and internationally. In addition, many hold senior roles within professional service firms, global companies, Government, Revenue, state bodies and the European Commission.

After 50 years, the Institute remains deeply committed to the role it can play in education, tax administration and tax policy in Ireland and in building an efficient and innovative tax system that contributes to a successful economy and society. We are also committed to the future of the tax profession, our members and our role in serving Ireland's taxpayers and best interests in a new international world order. Our *Irish Tax Series* publications and online database *TaxFind* are respected and recognised as Ireland's most extensive tax information sources.

Irish Tax Institute - Leading through tax education.

The Irish Tax Institute welcomes the opportunity to contribute to this consultation on the fair taxation of the digital economy.

1. The importance of the 'digital economy' to global economic growth

Businesses make enormous capital and human investment every year in digitising their operations. Such advances in technology and the digitalisation of the overall economy provide tremendous opportunities for the development and growth of the European Union. The EU, OECD, World Economic Forum and many others have recognised the important contribution that the digital economy is making to global growth.

European Commission Mid-term Review on the implementation of the Digital Market Strategy, May 2017

"It is essential that EU businesses grasp the opportunities of digital technology to remain competitive at global level, that EU start-ups are able to scale up quickly, with full use of cloud computing, big data solutions, robotics and high speed broadband, thereby creating new jobs, increased productivity, resource efficiency and sustainability."[1]

European Commission President Jean-Claude Juncker, Political Guidelines, 15 July 2014

"I believe that we must make much better use of the great opportunities offered by digital technologies, which know no borders." [2]

OECD, Key Issues for Digital Transformation in the G20 - Report prepared for a joint G20 German Presidency/ OECD conference, Berlin, Germany, 12 January 2017

"The ongoing digitalisation of the economy and society holds many promises to spur innovation, generate efficiencies, and improve services throughout the economy. Moreover, the successful transition to a digital economy is a necessary condition for boosting more inclusive and sustainable growth and enhancing overall well-being."[3]

[1] European Commission, Mid-term review on the implementation of the Digital Single Market Strategy – A Connected Digital Single Market for All, 10 May 2017 http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1496330315823&uri=CELEX:52017DC0228

[2] Political Guidelines for the next European Commission – A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change, 15 July 2014 https://ec.europa.eu/commission/sites/beta-political/files/juncker-political-guidelines-speech_en.pdf

[3] OECD, *Key Issues for Digital Transformation in the G20* - Report prepared for a joint G20 German Presidency/ OECD conference, Berlin, Germany, 12 January 2017 http://www.oecd.org/g20/key-issues-for-digital-transformation-in-the-g20.pdf

World Economic Forum - Shaping the Future of Digital Economy and Society

"The exponential growth in digitization and internet connectivity is the backbone of the Fourth Industrial Revolution. It has the potential to propel societies forward, enable innovative business models and help governments address legitimate policy concerns. Digitization is transforming business models, the policy landscape and social norms."[4]

2. The 'digital economy' is part of the broader global economy and cannot be ring-fenced

The European Commission Expert Group stated in its Report on the Digital Economy in May 2014;

"…there should not be a special tax regime for digital economies. Rather the general rules should be applied or adapted so that "digital" companies are treated in the same way as others."[5]

In October 2015, the OECD Task Force on the Digital Economy (TFDE) concluded;

"…because the digital economy is increasingly becoming the economy itself it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes."[6]

In many respects, it is a misnomer to refer to a 'digital economy.' In fact, the whole economy is becoming increasingly digitalised. To suggest that a distinct 'digital economy' can be ring-fenced from the traditional economy is unrealistic and in practice will be unworkable. For this reason, care should be taken to avoid creating a separate set of tax rules for "digital" businesses. To do so would require policy makers, tax administrations and taxpayers to make arbitrary distinctions every day about which businesses are "digital" businesses and which are not.

For all the opportunity that an increasingly digitalised economy offers, it is embedded in the overall global economy and whatever rules that are developed to

[4] World Economic Forum - Shaping the Future of Digital Economy and Society https://www.weforum.org/system-initiatives/shaping-the-future-of-digital-economy-and-society
[5] European Commission Expert Group on the Digital Economy Report, May 2014. https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/gen_info/good_governance_matters/digital/report_digital_economy.pdf
[6] OECD (2015), Addressing the Tax Challenges of the Digital Economy, Action 1- 2015 Final Report, OECD/G20 Base erosion and Profit Shifting Project, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264241046-en

deal with the tax challenges digitalisation brings, must equally apply to all businesses operating in the global economy.

3. Current problems identified in Section 4 of the questionnaire

Undoubtedly, the rapid digitalisation of the global economy has created challenges for international tax rules. However, the consultation questionnaire at 4.2 seeks views on a number of statements describing the possible problems posed by the 'digital economy'. We cannot express a view on the last two statements in that section, as these are more akin to political statements about the economy and the collection of revenues by Member States, rather than tax technical issues.

In any case, many of the tax challenges of the digitalisation of the economy are in the process of being addressed within the European Union, through the implementation of Base Erosion and Profit Shifting (BEPS) measures in the EU Anti-Tax Avoidance Directives, ATAD[7] and ATAD 2.[8] The progress made to date by these initiatives was acknowledged by five EU Finance Ministers in their joint letter to the US Secretary of the Treasury, Mr Steven Mnuchin, urging the US not to act unilaterally when reforming the US tax code.

The Finance Ministers of France, Germany, Italy, Spain and the UK stated in their joint letter to the US Secretary of the Treasury on 11 December 2017:

"In recent years, we have experienced an outstanding level of international co-operation in tax matters and fair taxation worldwide. With the BEPS compromise, we have opened up a new chapter of international cooperation in tax matters and fair taxation worldwide."[9]

The OECD's report on BEPS Action 1[10] acknowledges that the 'digital economy' does not generate unique BEPS issues; rather some of its key features exacerbate BEPS risks. The mobility of customers, business functions and intangibles inherent in digitalised businesses are recognised across the 15 OECD BEPS Actions and the overall approach of more closely aligning profits with value will resolve much of the misalignment between the business models and the tax rules.

Most EU countries are still only part way through the implementation of these BEPS and ATAD actions, with for example, Country-by-Country reporting currently bedding into the international tax framework. Until the details of the overall BEPS package

[7] Council Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market
[8] Council Directive amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries
[9] Letter from Mr Peter Altmaier, Mr Bruno Le Maire, Mr Philip Hammond, Mr Pier Carlo Padoan and Mr Cristóbal Montoro Romero to Mr Steven Mnuchin on 11 December 2017. https://www.scribd.com/document/366895201/Letter-from-six-EU-finance-ministers-to-US-Treasury-Secretary
[10] OECD (2015), Addressing the Tax Challenges of the Digital economy, Action 1- 2015 Final Report, OECD/G20 Base erosion and Profit Shifting Project, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264241046-en

have been agreed and BEPS and ATAD have been implemented, it is very difficult to assess the impact that these far-reaching changes will have on the 'digital economy.'

Indirect taxes also have an important role to play in the taxation of the 'digital economy' and cannot be dealt with in isolation to corporation tax. Just as the global corporation tax rules have not kept pace with the increasing digitalisation of the economy, VAT systems globally have struggled to define the place of supply of a digital service.

Steps to advance the VAT rules for the 'digital economy' and improve VAT administration and collection within the EU could result in significantly increased revenues for many countries, as work progresses on the corporation tax agenda.

The European Commission has identified a set of objectives in section 4.10 to be considered when designing legislative proposals for the 'digital economy.' We do not agree with these set of objectives, as any decisions on whether and how to address the tax challenges of the digital economy should be guided by the Ottawa taxation framework principles[11] of:

- Neutrality,
- Efficiency,
- Certainty and simplicity,
- Effectiveness and fairness, and
- Flexibility.

4. Possible solutions put forward in Section 5 of the questionnaire

The European Commission's short-term solutions as part of a two-step approach

This consultation outlines four temporary solutions to address the direct tax policy challenges of the 'digital economy':

a) Withholding tax on certain types of digital transactions;
b) Tax on revenues from certain digital services with a significant economic presence;
c) Tax on revenues from digital activities; and
d) Digital transaction tax.

We do not agree with a two-step approach. It is essential to adopt a long-term solution which works both for the digital and wider economy. Short-term solutions will increase tax uncertainty and create administrative burdens for business. The European Commission recognises the negative effects that tax uncertainty can have

[11] Electronic Commerce: Taxation Framework Conditions – A Report by the Committee in Fiscal Affairs, 8 October 1998 https://www.oecd.org/ctp/consuption/1923256.pdf

on *"investment, trade and compliance"*[12] and has begun a project in 2017 to improve tax certainty for businesses, as part of its Platform for Tax Good Governance.[13]

European Commission Working Paper No. 67 – 2017: 'Tax Uncertainty: Economic Evidence and Policy Responses', March 2017:

"At the international level, the key strategy to deal with tax uncertainty is better cooperation and more coordination between countries."[14]

Given the time it would take to agree and implement new legislation for a temporary solution, a long-term solution could be identified and agreed within that period.

Regarding the proposed temporary solutions, we have set out some specific comments below.

Withholding tax in certain types of digital transactions

The principle of neutrality is particularly relevant in the context of imposing a withholding tax on digital transactions. A lot of digital businesses operate on very low profit margins. Imposing a withholding tax on digital businesses would be a very "blunt instrument" to collect tax and could push many new entrants and small businesses into a loss-making situation.

The administration difficulties of a withholding tax must also be considered. Individuals in business to consumer transactions will not collect and pay over a withholding tax to the tax authorities. This then raises the question of efficiency. Who will collect the tax and how will it be administered? Will some type of collection agent be required to act as a withholding agent for the taxpayer and what costs will this add for them, in terms of complexity and uncertainty?

Tax on revenues from certain digital services with a significant economic presence

Introducing a "significant economic presence" threshold would create a new form of nexus for certain businesses that may not be regarded as having a permanent establishment (PE) by their physical presence under the existing Article 7 of the OECD Model Convention.[15]

OECD countries are currently dealing with proposed amendments to Article 7 under BEPS Action 7 and the Multilateral Instrument (MLI). Several countries have concerns

[12] European Commission Working Paper No. 67 – 2017: *'Tax Uncertainty: Economic Evidence and Policy Responses'*, March 2017 https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_paper_67.pdf
[13] Tax Certainty Paper presented to the meeting of the Platform for Tax Good Governance on 15 June 2017 https://ec.europa.eu/taxation_customs/sites/taxation/files/platform_tax_uncertainty.docx.pdf
[14] European Commission Working Paper No. 67 – 2017: *'Tax Uncertainty: Economic Evidence and Policy Responses'*, March 2017 https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_paper_67.pdf
[15] OECD Model Tax Convention on Income and on Capital 2014

about reducing the threshold for PE until there is more clarity surrounding the attribution of profits to such PEs. Even before considering a new nexus test for digital businesses, it is proving difficult to achieve certainty and consensus on the matter.

Attempting to attribute a PE to a business that has no presence in a country, other than perhaps gathering raw data there, presents challenges. Is this sufficient to create a nexus in that country and even if it is, what value can be attributed to that raw data, when all the people functions in extracting the value from it are located elsewhere?

Valid concerns also exist around the level of uncertainty that would result from undoubtedly very different interpretations of such a nexus by tax authorities even if global consensus could be reached on the definition of a "significant economic presence."

Businesses are already experiencing a rise in tax disputes in a post-BEPS era and it is likely that a widely drawn nexus test with related profit attribution rules could open digital businesses to a flood of international tax disputes.

Tax on revenues from digital activities and digital transaction tax

Introducing a tax on revenues from digital activities or a digital transaction tax on the collection of data would represent a tax payment based on gross revenue. The concerns raised above regarding a withholding tax on certain digital transactions would equally apply in terms of proportionality, ability to pay and the potential for widescale disruption and cost for both small and large businesses.

A digital transaction tax based purely on the collection of customer data would result in a different tax model for 'digital businesses' as compared with businesses in traditional sectors, which would be neither neutral nor fair. It would also create vast uncertainty around who falls within the definition of a digital business for tax purposes.

It is unlikely that such taxes would be creditable under existing OECD double taxation agreements and would therefore lead to multiple taxation of business profits globally.

Such taxes would also act in an arbitrary manner to favour economies with large populations, without recognising the fact that the value created in supplying these customers is likely to have been generated elsewhere.

The European Commission's long-term solutions

This consultation puts forward five options to address the current problems of taxing the 'digital economy' in the long-term. In terms of reaching a long-term solution to address the tax challenges of the 'digital economy', we agree with the conclusions of the European Commission Expert Group on the Digital Economy and by the OECD's TFDE in their 2014[16] and 2015[17] Reports respectively, that there should not be a special tax regime for digital companies and that the digital economy cannot be ring-fenced.

Many of the long-term solutions proposed by the European Commission focus on consumption and are at variance with the underlying principle of the BEPS project to align the taxation of profits with where value is created.

We believe that any further measures taken to address the specific tax challenges of the 'digital economy' should only be determined after the various business models and value chains involved are fully considered and there is a comprehensive understanding of the specific tax challenges posed by the key features of the 'digital economy.' In addition, a cost benefit analysis of introducing further changes for digital businesses is essential and we look forward to the publication of the interim report by the OECD's TFDE next April.

We believe that the best way forward to address the tax challenges of the 'digital economy' is by reaching consensus at international level. It is too early in the implementation of the BEPS project and ATAD to assess the BEPS risks that may persist in the digital economy under a post-BEPS taxation framework. We would strongly encourage the European Commission to continue to work within the OECD BEPS framework to build an international consensus on the taxation of the 'digital economy,' rather than taking unilateral steps to tax digital businesses.

The five EU Finance Ministers highlighted the importance of working within the OECD and BEPS Inclusive Framework to reach international consensus on tax matters in their letter to the US Secretary of the Treasury on 11 December 2017.

[16] European Commission Expert Group on the Digital Economy Report, May 2014. https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/gen_info/good_governance_matters/digital/report_digital_economy.pdf

[17] OECD (2015), Addressing the Tax Challenges of the Digital Economy, Action 1- 2015 Final Report, OECD/G20 Base erosion and Profit Shifting Project, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264241046-en

The Finance Ministers of France, Germany, Italy, Spain and the UK said in their joint letter to the US Secretary of the Treasury on 11 December 2017:

"The OECD and BEPS Inclusive Framework are the relevant forums for working on the evolution of international tax principles on a multilateral basis. Such dialog ensures consistency, which is crucial for states and all businesses."[18]

If careful consideration is not given to the imposition of new tax rules on digital businesses, they could be forced to fundamentally reform their business models, forcing them to set up establishments in countries worldwide that are completely unnecessary from a business point of view, purely to satisfy tax rules. This would clearly be a regressive step in the development of the digital economy and would run contrary to the stated digital strategy of the European Union.

By way of completeness, please note that we have not answered section 5.7 of the questionnaire on the basis that the Irish Tax Institute is not a tax administration.

Furthermore, we have not completed section 5.8 regarding the application of a possible digital tax to Small and Medium Enterprises, as we do not agree with a digital tax being imposed on large or small companies.

5. Conclusion

Whatever solutions are chosen must work effectively for the 'digital economy' and the wider global economy. They should be fair and effective, not giving rise to multiple tax charges, and they should be reached by international consensus as was the case with the broader BEPS actions. While this framework for agreement may require time, we believe it offers the best prospect for sustainable progress in a very complicated and continually evolving area of international taxation.

[18]Letter from Mr Peter Altmaier, Mr Bruno Le Maire, Mr Philip Hammond, Mr Pier Carlo Padoan and Mr Cristóbal Montoro Romero to Mr Steven Mnuchin on 11 December 2017. https://www.scribd.com/document/366895201/Letter-from-six-EU-finance-ministers-to-US-Treasury-Secretary