Irish Tax Institute Opening Statement to

Select Committee on Finance, Public Expenditure and Reform, and Taoiseach

RE: EU proposals on Taxation of the Digital Economy COM(2018)147 and COM(2018)148

Thursday 3 May 2018

In her opening remarks Irish Tax Institute Communications Director Olivia Buckley said:

"The breadth and pace of digitalisation in the world is such that the world's largest bodies including the IMF, the OECD, the EU and the World Economic Forum are dedicated to understanding its impact and implications for policy makers.

The World Economic Forum has said that "technology will transform most industries - digitalization is one of the most fundamental drivers of transformation ever**"**.[1]

The OECD in its BEPS Action 1 Report 2015[2] acknowledged that it would be difficult, if not impossible, to 'ring-fence' the digital economy from the rest of the economy for tax purposes because of the increasingly pervasive nature of digitalisation. Instead, it considered digitalisation as a transformative process affecting all sectors brought by advances in ICT. The IMF too highlights this point stating that the "digital economy" is sometimes defined narrowly as online *platforms*, and *activities that owe their existence to such platforms,* yet, in a broad sense, *all activities that use digitized data are part of the digital economy: in modern economies, the entire economy*[3].

The IMF points to the fact that there are no agreed definitions of digital sector, products or transactions, let alone the digital economy. It says, "estimates of the size of the digital sector can be sensitive to the choice of definition".

Tax implications

The international tax implications of such change and complexity is under intense analysis in the OECD and in the EU:

- The OECD in its BEPS Action 1 Report recognised that digitalisation and some of the business models that it facilitates present important challenges for international taxation. It says that "for tax matters, this means that policy development and implementation must be designed to allow for the changing environment, while being sufficiently clear to provide the certainty and clarity that facilitates sustainable, long-term economic growth". The aim of the OECD is to find a durable long-term solution.

[1] World Economic Forum White Paper Digital Transformation of Industries: Digital Enterprise, January 2016
[2] Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD, October 2015
[3] Measuring the digital economy, International Monetary Fund, February 2018

- The European Union is also putting forward tax policy changes, both of a short term and long-term nature, which we refer to in this presentation.

Much work has been done through BEPS to reform outdated global tax rules over the past five years. The OECD states that we are already starting to see companies realign their business models to be BEPS compliant and that this is having an impact on where they pay tax. Ireland is an example of this with CT receipts increasing to €8 billion this year.

However, there is universal acceptance that the established corporate tax framework, which taxes profits based on where value has been created, has not evolved to match the digitalisation of global businesses – as our Tax Policy Manager, Anne Gunnell will now explain".

Irish Tax Institute Tax Policy Senior Manager, Anne Gunnell:

"The global tax rules are strongly rooted in physical presence (this is largely determined by the Permanent Establishment (PE) test/PE rules).

The effectiveness of existing global tax rules is challenged by the ongoing digitalisation of the economy to the extent that value creation is becoming less dependent on the physical presence of people or property.

One of the key challenges is that the PE test does not reflect modern business models. Policy makers are working on the challenges and examining such issues as "the collection and exploitation of data, network effects and the emergence of new business models, such as multi-sided platforms, as exacerbating the challenges to the existing tax rules"[4].

New rules dealing with the taxation of modern business models will also have to address how profits are allocated ("Profit allocation rules" relate to how much "the share" of a multinational's profits should be taxed in a given country).

The work of the OECD on the taxation of the digital economy is continuing as outlined in its interim report 'Tax challenges arising from digitalisation' published in March 2018. It has resumed its work, including the monitoring of developments in digital technology and business models, the individual measures taken by countries to address the broader tax challenges raised by digitalisation, and the extent of implementation and impact of the relevant Actions from the BEPS package.

David Bradbury, the head of the OECD's tax policy and statistics division[5], said "Everyone within the inclusive framework – 113 countries – have all agreed that we should continue to work towards a global consensus-based solution. That is the ultimate answer, and unless we're able to achieve that it's likely that there will be a range of adverse economic consequences that will flow from unilateral measures. So, the best way is to move forward together."

EU Proposals

In March 2018, the European Commission also came forward with two legislative proposals to deal with challenges in taxing the digital economy – an interim and a long-term measure.

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[4] Tax challenges arising from digitalisation – Interim Report 2018, OECD.
[5] Interview with David Bradbury, Head of the OECD's Tax Policy and Statistics Division, *International Tax Review*

In the short term the EU proposes a Digital Services Tax. This measure is targeted at larger digital companies that generate revenue by supplying digital services within the EU.

The tax will be imposed at 3% of gross revenue, taking no account of a business' profitability or margin. Hence a highly profitable company would get taxed at the same level as a loss-making company.

The levy is focused on a small number of companies with global annual turnover exceeding €750m. The charge is not creditable against other corporation tax paid and will therefore lead to some double taxation.

EU Long term solution

The EU also proposes a long term comprehensive solution based on a new Significant Digital Presence (SDP). The comprehensive solution will apply to a much wider range of companies. This comprehensive solution is expected to form part of the EU's ambitions for a CCCTB[6].

Our Tax Policy Director Cora O' Brien will critique the proposals and examine the EU and global reaction to them":

Irish Tax Policy Director Cora O'Brien:

Critique

"The Irish Tax Institute believes there are several concerns regarding the EU's proposals:

- The EU would be moving unilaterally, rather than in co-ordination with the rest of the world, which could create protracted global tax disputes.
- EU companies could be adversely impacted if other non-EU countries apply similar levies in response, impacting the EU's competitiveness.
- Any measure that is a bridge to CCCTB creates concern about the loss of tax sovereignty.
- Temporary taxes that deliver funds for certain countries can be hard to remove and disruptive. They could become a permanent levy on doing business in the EU.
- Legal challenges could be brought against the proposals under several headings: on the grounds of discrimination (having a special tax regime only for digital companies), on the grounds of proportionality and on the grounds that it is another turnover tax and therefore incompatible with EU law[7].
- Any new framework for taxation in a digital environment should not create double taxation for companies. However, double taxation will arise with a short-term levy that is not creditable.
- The EU approach is likely to trigger the need for EU countries to renegotiate their treaties with third countries. The interim measure will continue to apply with third countries in circumstances where the tax treaty has not been updated to reflect the new rules for SDP (the proposed long-term solution). Members States, including Ireland, may not have control

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[6] Interview with Stephen Quest, DG DGTAXUD, *International Tax Review,* 2018.

[7] Mr Philip Baker QC, commenting on the Digital Services Tax at the CFE Tax Advisers Europe Forum on Fair Taxation of the Digital Economy, Brussels, 19 April 2018.

over new treaties as it's a bilateral action depending on agreement being reached with the third country.

- There has been no impact assessment by the EU.
- One of the most important policy principles of a new tax is that it is easily administrable. A 3% annual pan EU levy raises a number of administration challenges for tax administrations.

Member State reaction and global reaction

Reports from the recent informal meeting of Ecofin[8] indicate growing concerns and opposition to the EU interim measure, with preferences being strongly expressed for a long-term global solution. Concerns are emerging from both small and larger EU Member States.

Ángel Gurría, Secretary General of the OECD, who attended the ECOFIN meeting, said work for global reform, which would include the United States, Japan and China, was already under way and cautioned against adopting measures that could be inconsistent with a long-term solution[9]. Mr. Gurría, when he spoke about the project in Dublin in March this year stressed that "We are not talking about taxing a company or a few companies. We're talking about how you tax an increasingly digitalised economy in the world."

Reports from the Asia-Europe Meeting Finance Ministers' Meeting (ASEM FinMM) last week [10] highlight that China, the world's second largest economy with 19% of the world's population, also supports a global approach to digital tax[11] and opposes the EU interim measure.

Conclusions

While we accept that the challenges of taxing the digital economy must be addressed we believe that when it comes to international corporate tax, a global rules-based system based on international agreement is critical. What the EU is proposing is a unilateral measure to something that needs a global response. It is important to have the same rule book for all countries.

Global tax policy must be principles based and based on international agreement if it going to be durable and sustainable and is adaptable to the constantly changing nature of the digital economy. Measures introduced today could be quickly superseded by further digital evolution.

It must also be implemented in a common and coordinated way globally.

This is a very complex undertaking. There is huge diversity in digital business models before you even consider how the tax rules apply to them all.

Reforming the tax rules for a globalised economy is an important and radical move. It requires a global solution", concluded Ms. O'Brien.

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[8] Informal Ecofin, Sofia, Bulgaria, 28 April 2018.
[9] Interview with Ángel Gurría, Secretary General of the OECD, Bulgarian Presidency of the Council of the European Union, 28 April 2018: https://vimeo.com/266991157.
[10] Asia-Europe Meeting Finance Ministers' Meeting (ASEM FinMM), 26 April 2018.
[11] *Sunday Business Post*, 29 April 2018.