



**Irish Tax  
Institute**

*Leaders in Tax*

# **Irish Tax Institute**

## **Response to OECD Discussion Draft: Address the Tax Challenges of the Digital Economy**

**April 2014**

## **About the Irish Tax Institute**

The Irish Tax Institute is the leading representative and educational body for Ireland's AITI Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax. Our members provide tax expertise to thousands of businesses and individuals in Ireland and internationally. In addition many hold senior roles within professional service firms, global companies, Government, Revenue and state bodies.

The Institute is the leading provider of tax qualifications in Ireland, educating the finest minds in tax and business for over thirty years. Our AITI Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice.

A respected body on tax policy and administration, the Institute engages at the most senior levels across Government, business and state organisations. Representing the views and expertise of its members, it plays an important role in the fiscal and tax administrative discussions and decisions in Ireland and in the EU.

The Irish Tax Institute welcomes the opportunity to contribute to the debate on BEPS Action 1 – Addressing the Tax Challenges of the Digital Economy.

This particular Discussion Draft is a comprehensive paper that outlines the OECD’s research into:

- The Definition of the Digital Economy;
- Ways in which base erosion and profit shifting can arise within a digital economy;
- How the wider BEPS Actions will address problems arising in the digital economy;
- The broader challenges associated specifically with the digital economy; and
- Options to address these broader challenges.

### **The “digital economy” is a source of opportunity**

Businesses make enormous capital and human investment every year in digitizing their business. Such advances in technology and developments in the digitisation of the overall economy provide tremendous opportunities for development and growth for OECD countries. In reviewing the tax framework for businesses operating within the digital economy, it is important to recognise the huge potential for expansion and ensure that measures taken do not create unnecessary barriers or complexity which could restrict this development.

### **The difficulty of defining the “digital economy”**

The challenge of defining the “digital economy” occupies half of the entire 68 page analysis within this Discussion Draft document – what does the term “digital economy” actually mean?

Unless we can clearly define what the digital economy means, it is very difficult to see how the OECD can seek to apply separate and specific rules to it e.g. do the rules apply only to businesses supplying certain types of digital goods and services; do they apply to businesses carrying out their activities through certain digital means and media etc?

It is acknowledged in the Discussion Draft itself that it is difficult, if not impossible, to isolate a separate digital economy, given that digital business is now fundamentally embedded into business generally.

Paragraph 59 of the Discussion Draft concludes that:

*“As digital technology is adopted across the economy, segmenting the digital economy is increasingly difficult. In other words, 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. Attempting to isolate the digital economy as a separate sector would inevitably require arbitrary lines to be drawn between what is digital and what is not.”*

The difficulty of trying to separately deal with the digital economy has also been recognised by the Irish government in our Minister for Finance’s recent comments on the Discussion Draft:

*“The digital economy is not a specific sector of the economy anymore rather the whole economy is becoming digitised”.*

And the European Commission’s paper<sup>1</sup> published by the Expert Group on the Digital Economy states:

*“Because of the ever-changing technologies of the ICT sector and because of the widespread diffusion of the digital economy within the whole economy, it can no longer be described as a separate part, or subset, of the mainstream economy.....Given that the digital business models are present in more and more sectors of the economy it is not possible to come up with the size of the digital economy as a percentage of GDP”.*

The Commission’s paper also references the explosive growth in the Internet of Things, whereby:

*“...nearly every aspect of human life and economic activity is being equipped with networked sensors and actuators that monitor the surrounding environment, report their status, receive instructions and even take action based on received information.”*

If experts cannot even measure the size of the digital economy, then how can we separately tax it?

### **Focus on the overall international tax framework**

The quest to segment the digital economy from the larger economy is fraught with difficulty and risk. Technology changes on a daily basis and a business that is not in the digital economy today, could be part of it in 3 or 6 months’ time under an arbitrary definition. Therefore the exercise of trying to ring-fence the digital economy is one that will require refinement and review on an almost continuous basis.

In our view, the efforts of the international community would be much better served by working together to reform the general rules and framework of international taxation, within which all businesses operate, including digital businesses. This is the overall goal of the BEPS project and one which the Irish government is firmly committed to.

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<sup>1</sup> Working Paper: Digital Economy - Facts & Figures, March 2014. Available at: [http://ec.europa.eu/taxation\\_customs/resources/documents/taxation/gen\\_info/good\\_governance\\_matters/digital/2014-03-13\\_fact\\_figures.pdf](http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/good_governance_matters/digital/2014-03-13_fact_figures.pdf)

*“Ireland welcomes the BEPS project and also the co-ordinated effort at OECD/G20 level to deal with the challenges BEPS poses.”<sup>2</sup>*

The broad range of Actions 2 – 15 in the BEPS Action Plan, deal with the fundamental principles of international taxation i.e. CFC rules, treaty abuse, permanent establishment, transfer pricing, mismatches etc. This Discussion Draft on Action 1 rightly highlights that the process of reforming these fundamental principles will itself change the way in which digital businesses are taxed.

These work streams in the Action Plan are focused on refining the approach of the current source based system of taxation for income taxes to achieve outcomes whereby the recognition of taxable profits is aligned with substance and activity. We consider this source based approach to be the correct one for income taxes and to be equally applicable to businesses which have limited physical presence in the market of the consumer.

We believe that the combination of a source based income tax system with the adoption of a destination based VAT or indirect tax system should adequately address concerns about base erosion in consumer markets. We believe that this combination of approaches builds on existing principles and provides a framework to support the evolution of and future growth potential for businesses participating in the digital economy.

The Irish Tax Institute believes that this focus on the overall tax framework is the correct way to approach the challenges of the digital economy. The BEPS Action Plan is due to be completed by the end of 2015 and is likely to represent the biggest reform to international tax rules in 70 years. Businesses will require time to adjust to this level of reform. The way that businesses operate will no doubt change as a result of this work and we believe that this process of change should be allowed to take place and the results reviewed before it is determined whether any additional actions are needed to address the tax challenges of the digital economy.

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<sup>2</sup> Ireland’s International Tax Strategy Statement, October 2013. Available at: <http://budget.gov.ie/Budgets/2014/Documents/Department%20of%20Finance%20International%20Tax%20Strategy%20Statement.pdf>