14 December 2017

CBI RESPONSE TO EU COMMISSION'S CONSULTATION – FAIR TAXATION OF THE DIGITAL ECONOMY

Background

As the UK's leading business organisation, the CBI speaks for some 190,000 businesses that together employ around a third of the private sector workforce, covering the full spectrum of business interests both by sector and by size.

Thank you for the opportunity to provide input on the questions you are considering as part of your policy making on taxation of the digital economy. The questions in the consultation cover large and complex topics and are very difficult to respond to with the closely prescribed answers made available. Accordingly, we think there is a significant risk of misinterpretation of the responses provided. Therefore, we would like to supplement our answers to the consultation questions with some more general points about tax policy making in response to digitisation of the economy. We would hope that these points are given more weight than the responses to the questionnaire. A summary of key points is provided for you below. If you have any questions or would like any further detail, please do not hesitate to get in touch.

We look forward to continuing to work with you as your work in this area progresses.

Key points

- Our highest priority is finding a common global approach to international tax reform in response to digitisation of the economy.
- The European Commission ("EC") should form a considered view on the problems that need to be solved and participate with global partners to reach agreement on the problems at hand.
- Clear articulation of the problem will drive development of solutions and the EC can play a valuable role in identifying solutions and supporting consistent adoption within the EU.
- To support efforts of developing a common global solution, measures developed within the EU should be aligned with the existing international tax framework and be capable of multilateral adoption by countries within and outside the EU. No action should be taken at an EU-only level.
- Solutions developed within the EU should also be aligned to the Ottawa principles to ensure the growth that digitisation promises can be realised.
- To ensure sufficient progress is being made, the EC should seek to agree a timetable with global partners.
- The EC must undertake macro-economic impact assessments of solutions it wishes to pursue to truly understand the impact on countries, consumers and companies.

Risks of un-coordinated action

For businesses, the greatest concern in the current debate on how to reform the international tax framework is the prospect of un-coordinated action on a global scale. For business, this is expected to result in increased tax costs, compliance burdens and resource spent in controversy management, as well as inevitable double taxation. Ultimately, it could cause some businesses to question viability of their business model (or parts of it, e.g. particular markets) or could encourage businesses to regress on adoption of technology thereby undermining growth potential.

We would expect these risks to have a negative impact on global economic growth and on consumers. Therefore, we think it should be a high priority for governments to find multi-lateral solutions to the precisely identified problems. We welcome the EC continuing to work with global partners under the OECD framework on this topic and treating a global solution as their preferred option.

Importance of identifying the problem to which solutions are needed

Due to the continued and increasing digitisation of our economy, we agree that it is appropriate to undertake a review of the existing international tax framework to assess whether it remains fit for purpose. If it is concluded that there are deficiencies with the existing system, we also agree that appropriate action should be taken. At the current stage, it our view that this assessment has not yet been properly undertaken by the Commission and member states. Of course, different countries may have a different view on what the "problem" is, but it is not possible to develop solutions when the problem is not defined.

On reading the EC's Communication[1], we are concerned with the intention to progress rapidly to implementation of "solutions" before the nature of the digitising economy and the problem or problems it poses for international taxation have been properly assessed and understood.

It is noted in the Communication that the impact of the digital economy on the international tax system presents a multidimensional challenge and there is a lack of international consensus on how the digital economy should be taxed. To us, the complexity of the challenge drives an even greater need for a proper assessment and international agreement upon the nature of the problems to be tackled as the first step. By taking this step, we are of the view that more robust and well thought through solutions will be developed.

If instead, countries (including within the EU) jump too quickly to deliver solutions we think there is a high risk of collateral damage or unintended consequences for countries and consumers as well as companies. This is particularly so, if the political desire to deliver a solution is in response to public perceptions that are one dimensional or based on misunderstandings of the corporate tax system (revenues versus profits). For example, there may be perceived public support for additional taxes on digital business models, but this support may rapidly evaporate if the result is a higher cost for the public. Interim measures need careful assessment, as for any long-term measure, because they can become quasi-permanent.

The conclusions agreed at the 5 December meeting of ECOFIN ministers have demonstrated that the finance ministers do indeed separate the issue of BEPS (which must continue to be acted upon through encouraging adoption of anti-BEPS measures) from that of reform of the international tax system in response to digitisation of the economy. This is a helpful progression in the EU debate, but we strongly encourage the EC to more deeply articulate the challenges that digitisation is posing for the

[1] Communication from the Commission to the European Parliament and the Council – A Fair and Efficient Tax System in the European Union for the Digital Single Market – 21 September 2017

international tax framework so as to further progress the debate within the EU and with global partners.

Business stands ready to support with solutions development once the problems are more clearly defined. Until then it is incredibly difficult to provide meaningful input or detailed viewpoints on the different solutions being presented.

One example is the narrowing focus on user-based activity. This is an area in which businesses from a range of sectors and at different stages on the path of digitisation will have evidence to provide. The collation of data is not a new activity and is carried on by both highly digitised and more traditional businesses. This type of activity may be similar between a large number of businesses. There will be no simple solution to developing a measure which is based on targeting user-based activity that is considered to drive significant value. Policy makers need to invest time and resource in better understanding the way that user-activity relates to value-generation in a range of different businesses. It is incredibly important for policy makers to have this evidence so that they are better placed to understand the whole economy impact that new tax measures will have.

Another example would be the need to recognise that many digital businesses are still evolving. For example, in the area of digital advertising, transparency over viewability of digital advertisements and therefore payment for the same, is a current challenge that is in the process of being tackled with the final answer not yet delivered. An ill-conceived tax measure at this point could drive business restructuring in a direction that does not represent the most productive long-term solution for global economic growth.

European Commission proposed measures

As described above, we think clearly defining the problem or problems should drive the solution development.

We are supportive of the role that the EC can make in identifying possible measures for taxation of a digitised economy. This should help drive a co-ordinated approach within the EU as part of global reform. But to deliver on that, the solutions developed by the EC must be aligned with international tax principles and be suitable for global adoption. It is for this reason that we have fundamental concerns with some of the proposals being considered by the EC. For example:

- Turnover based taxes present a significant shift from taxing corporates based on profits and could be very detrimental to SMEs who are competing with more established digital businesses.
- Whilst we welcome the fact that the digital PE concept is a measure based on taxation of profits, the option raises some significant practical challenges in terms of defining the PE and then allocating profits to it. Introducing this concept would impose new barriers to entry in terms of the administrative costs of registering in multiple jurisdictions.
- The CCCTB is relevant only for those business elements conducted within the EU, and would still need international agreed principles for transactions into and out of the EU. It also seems very unlikely that governments outside of the EU would adopt a CCCTB solution in the near term, given that the choice of formula will create winners and losers and also requires consistent interpretation in order to avoid under or over taxation.

Please refer to our response to the OECD request for input from October 2017 where we shared some more detailed thoughts on the broad range of measures being considered. A link to the document is provided here: https://www.oecd.org/tax/beps/tax-challenges-digitalisation-part-1-comments-on-request-for-input-2017.pdf

As solutions are further developed at the EU-level we strongly encourage the EC to make use of the OECD's taxation principles as laid down in the BEPS Action 1 final report. Originally aimed at the emerging e-commerce economy, these were developed to ensure that tax measures did not suppress growth that the digital sector could deliver. This remains an imperative objective today for the broader digital economy to which the principles (as updated in the BEPS Action 1 final report) can be applied. Our slide attached, summarises these principles. The ambition of delivering a solution that is aligned with these principles gives further reason to clearly articulate the challenge being faced, e.g. in order to be able to apply the final two principles (Flexibility and Sustainability; and Proportionality).

Final remarks

We would encourage the EC to act quickly to work with the OECD to agree the timetable under which the longer- term solution will be developed. This should enable countries within the EU to signal a political commitment for progress, whilst ensuring that time spent on the important detailed work underpinning a sustainable solution. It would also enable broader stakeholders to understand what the EC's expectation of "sufficient progress" is.

As highlighted above, we think there is a real risk of unintended consequences resulting from the measures being considered. In respect of both the short and long-term measures being considered, we urge the EC to carry out thorough macro-economic impact assessments. For instance, taking into account any behavioural changes that could follow introduction of the measures.

OECD Digital Tax Principles

"A key principle overlaying the OECD's work on electronic commerce is the creation of an environment in which electronic commerce can develop its full potential. For tax this has required a fiscal environment that strikes a balance between development of electronic commerce and the need to secure the revenue base on which so much government expenditure is based."

Implementation of the Ottawa Taxation Framework Conditions, OECD, 2003

Major releases timeline

- **1997:** Joint government and business conference in Finland; *Dismantling the Barriers to Global Electronic Commerce*
- **1998:** OECD Ministerial Conference in Ottawa; *A Borderless World – Realising the Potential of Electronic Commerce*. Five key e-commerce taxation principles endorsed.
- **2001:** Taxation and Electronic Commerce Interim Report.
- **2003:** Implementation of the Ottawa Taxation Framework Conditions Report
- **2015:** BEPS Action 1 Final Report; Amends and adds to the Ottawa Principles.

Neutrality (Ottawa)

- Taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce. Business decisions should be motivated by economic rather than tax considerations.
- Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.

Efficiency (Ottawa)

- Compliance costs for taxpayers and administrative costs for the tax authorities should be minimised as far as possible.

Certainty and Simplicity (Ottawa)

- The tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction, including knowing when, where and how the tax is to be accounted.

Effectiveness and Fairness (Ottawa)

- Taxation should produce the right amount of tax at the right time.
- The potential for tax evasion and avoidance should be minimised while keeping counter-acting measures proportionate to the risks involved.

Flexibility and Sustainability (Ottawa – amended by BEPS Action 1)

- Options should be evaluated based not only on whether they address the tax challenges in the current environment, but, to the extent possible given the difficulty of predicting future developments, on whether they can be expected to be flexible and dynamic enough to adapt to future commercial and technological developments

Proportionality (BEPS Action 1)

- It is important to evaluate not only whether the proposed options address those tax challenges, but also what broader impact those options may have.
- Potential options shall be tailored to the scope of the particular challenges they are intended to address.