CBI

13 October 2017

CBI RESPONSE TO REQUEST FOR INPUT ON WORK REGARDING THE TAX CHALLENGES OF THE DIGITALISED 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 continued work on Base Erosion and Profit Shifting ("BEPS") under Action 1: Addressing Tax Challenges of the Digital Economy. The period made available for businesses to consider these questions and provide input has been relatively short. So, we will be very happy to host a meeting with you so you can hear the views of our members in more detail if that would be helpful. Similarly, if there are any areas where you would like us to provide additional written information then please don't hesitate to get in touch.

We are keen to stay very closely involved in this initiative, in particular with the dialogue by which governments become more informed about how digitised businesses work.

General remarks

The CBI are members of BIAC and we support the messages made in their response to your request for input. We especially support their statement that there is a need for *"a serious and sustained conversation, not just between governments but with the businesses, large and small, that are driving, and accelerating this digital revolution."* We will be happy to support your continued work by sharing viewpoints from the businesses amongst our member base.

We expect that the OECD will have received a limited amount of input from small and medium sized businesses ("SMEs") so far and this consultation, with its short response period, will be challenging for SMEs to participate in. We highlight below the importance that we think this group of businesses have in this policy area and so we strongly encourage the OECD to take sufficient time to ensure everyone has had a chance to contribute to this debate.

Before responding to the specific questions that have been posed, we would like to outline some general points relating to digital as a driver for growth and taxation of the digitised economy, which our members are keen to raise.

Digital as a driver for growth

We are pleased to see that the OECD is taking a strong interest in the impact of digitisation on the economy. For example, with the Going Digital project stating an ambition to "give policymakers the tools they need to help their economies and societies prosper in a world that is increasingly digital and data-driven".

We are in absolute agreement that the digitisation of our economies will be a major driver for growth in the world economy. For us, it is then incredibly important that tax measures applicable to digitised businesses can facilitate rather than hinder this growth.

We are concerned about the tendency for governments to be more protectionist in their stance towards tax policies. In the context of the policy debate on taxation of the digitised economy, we are worried by the risk of multiple countries implementing unilateral uncoordinated measures as resulting economic costs will likely have a negative impact on global trade and investment. We have some fundamental concerns about the compatibility of some of the proposed tax measures with trade obligations and European Union (“EU”) law. Further, we recognise that where multiple countries seek unilateral action, businesses are likely to experience increased compliance burdens, uncertainty over tax positions and risks of multiple taxation on the same profits.

We think the OECD has an important role to play in helping governments to understand the potential macro-economic impact of the new tax measures being proposed.

Some of the key points impacting growth that have been consistently raised in the discussions with our members are:

1) It is commonly perceived that highly digitised businesses have large profits, but it is often the case that such businesses are not profitable until they reach sufficient scale. We believe start-up businesses must be supported in order to drive competition, fuel growth and increase the number of these businesses that reach profitability.

2) Digital developments can have a particularly beneficial impact on the economies and societies of developing countries; and

3) Digital technologies are enabling all businesses to evolve in the way they operate and in the goods and services they deliver and we believe this is a key driver for economic growth. A difference in treatment between taxation of digital and non-digital operations could create a bias towards traditional ways of doing business.

Taxation of the digitised economy

As stated by the OECD in their Going Digital ambition, the world is becoming increasingly digitised and data-driven. We remain in agreement with the recommendation in the OECD 2015 BEPS Action 1 report that the “digital economy” should not be ring-fenced for tax purposes. The variety of business models amongst our member base demonstrates that it is increasingly difficult to separate what might be described as a “digital business” from more traditional businesses and this trend will only continue.

It seems to us that there is currently confusion on what the problem is to which a solution is sought. For instance, is the current question one of

- whether tax avoidance continues within multinational companies;

- whether there is something going undertaxed in new operating models of digitised businesses; or

- whether digitisation enables greater centralisation of activities such that profits are allocable to fewer jurisdictions?

The appropriate solution depends upon which of these one is seeking to address and with greater clarity on the question that is being posed, we think businesses can provide more information targeted towards that endeavour.

Our initial thoughts on each of these questions are set out below for your consideration.

Tackling any remaining tax avoidance practices

There may be a perception from some countries that tax avoidance continues due to a gap between the tax regimes of other countries, in particular the US tax regime. Substantial work has been undertaken to tackle tax avoidance practices through the OECD BEPS project and this needs more time to take effect. In addition, if US tax reform is delivered this could ease the concerns that some countries are expressing.

With regard to the progress made under the OECD BEPS project, we believe it is too early to prove whether substantial tax avoidance opportunities continue to exist following the BEPS conclusions being agreed upon and implementation commencing. We think there are tools at the disposal of governments that are not yet fully utilised or which have been introduced but have not yet had time to take effect. We would encourage governments to explore these further before developing new measures. For instance, this may include introduction of updates to the Transfer Pricing guidelines or anti-hybrid legislation (where countries have not yet done so) and full utilisation of increased information and powers to rigorously apply transfer pricing principles (e.g. proper evaluation of Country by Country ("CBC") reports which companies have not yet been required to submit).

If in due course the BEPS measures are fully reviewed and seen as unsuccessful, the question of why they failed would need to be carefully considered before next steps could be agreed. We think it is important that the consensus achieved over the BEPS principles is not readily abandoned, given the time and investment that governments and businesses have already invested in this process.

Perception of undertaxed activities in digitised businesses

A fundamental issue at the heart of the debate on taxation of the digital economy is the pressure that digitisation places on the concept of having a "presence" in a market. Some will argue that this presence is currently going undertaxed.

We see the need for a detailed review of whether such market presence should be recognised within our corporation tax framework. If the interaction between consumer (or user) and the business does not result in value creation for the company (and associated enterprises), then in our view these interactions should not be taxed within the corporate tax framework. Corporation tax is currently based on the principle of taxing a company on profits where those profits arise, i.e. where value is created. If, on the other hand, the interactions in-market do create value for the company above the value created elsewhere in the group, then it might be considered appropriate to capture this within the corporate tax system but only to the extent of that value creation and with no force of attraction. However, there are clear issues of measurement and so this might not be a workable solution.

Centralisation of profits and a new allocation of taxing rights

The process of digitisation, which includes an increased reliance on IP, may enable centralisation of profit generating activities in fewer countries. This concentration of profits and, accordingly, taxing rights can create pressure from some countries to agree upon a new allocation of taxing rights.

In this debate, we think it is important to recognise the range of taxes that countries have available as instruments of fiscal policy. Even where there are sales in a country, if there is no value creation there then we consider there should be no corporation tax due in that country. Instead income tax has been paid on the money spent and VAT/sales tax likely paid on the sale. As a result of the changing economy, countries might choose a different mix of tax. We think there is an important role that the OECD can play in increasing understanding amongst stakeholders about the range of taxes that apply to digital businesses.

Just one example are the changes that have been made to indirect tax rules that ensure countries can continue to raise tax revenue from digital supplies of goods and services. These are important developments and should be widely recognised.

Next steps

There is mounting political pressure from some countries on the need to introduce new tax measures for digital or digitised businesses. Despite this, we would strongly encourage the OECD to refrain from progressing rapidly to build consensus around any one of three options from the 2015 BEPS Action 1 report (a digital PE, a withholding tax, or an equalisation levy). All three of these models have fundamental challenges and they therefore cannot be concluded on at an early stage. We believe the OECD should take a longer term and considered approach in assessing what could be an appropriate measure for multilateral adoption.

It seems there has been little evidence collated from business on the implications that such measures could have. A lot more economic analysis and inter-governmental discussion is needed on them, as any of the measures would drive a major change in the approach to computation of tax revenues and their allocation to countries that would presumably not be acceptable to any country without proof that their public expenditures will not be left unfunded. Further, each model involves potentially dramatic double taxation implications which existing dispute resolutions mechanisms may be technically or practically powerless to resolve in any comprehensive, transparent and therefore acceptable way.

We welcome the OECD commencing a meaningful conversation between governments on taxation of the digitised economy now, but we urge the conversation in the immediate term to be focussed on reaching consensus on the way forward to build a suitable multilateral option. In our view, the OECD has an incredibly important role to play in preventing a wave of unilateral uncoordinated actions being taken in the short term.

Despite the views shared here on the options from the 2015 OECD BEPS report, we have shared in this paper some more detailed viewpoints on each of these options.

Comments on draft outline of the interim report

Thank you for sharing the proposed outline for your report. It is helpful to understand the direction of the OECD's work. We have a couple of comments on the outline interim report provided, as follows:

- We note the intention for the options (either existing or newly proposed) to be described in the report. We would encourage such description to include an assessment of the pros and cons of the measures. Given that the information in this report will undoubtedly be considered by policy makers in deciding whether or not to pursue certain unilateral actions in the short term, we think it is important for the pros and cons to be clearly documented and in the public domain. This should also support further meaningful debate on the different options in the near term.

- We think it is helpful that the topic of digital tax administrations has been captured in the report. This is an area of increasing interest to our members given that more and more tax authorities are starting to explore the use of digital. We hope that inclusion of the topic within this framework will help to drive consistency in approach. Digital tax administration is also a topic which is inextricably linked to new digital business models and taxation of them. There is an increasing number of examples where tax administrations want corporates to play a role in administering tax on their behalf, so it is important that business is brought into the discussion on this topic early.

Responses to specific questions posed

A. Digitalisation, Business Models and Value Creation

A.1 The process of digitalisation has become one of the main drivers of innovation and growth across the economy. Please describe the impact of this process on business models, and the nature of these changes (e.g. means and location of value creation, organisation, supply chains and cost structure).

A.2 Highly digitalised business models are generally heavily reliant on intangible property (IP) to conduct their activities. What role does IP play in highly digitalised businesses, and what are the types of IP that are important for different types of business models (e.g. patents, brands, algorithms, etc.)?

A.3 Digitalisation has created new opportunities in the way sales activities can be carried out at a distance from a market and its customers. How are sales operations organised across different highly digitalised business models? What are the relevant business considerations driving remote selling models, and in which circumstances are remote selling models (as opposed to local sales models) most prevalent?

A.4 Digitalisation has permitted businesses to gather and use data across borders to an unprecedented degree. What is the role of data collection and analysis in different highly digitalised business models, and what types of data are being collected and analysed?

A.5 In a number of instances, businesses have developed an architecture around their online platforms that encourages the active participation of users and/or customers from different jurisdictions. Is the establishment and operation of such global (or at least cross-country) user networks new and specific to certain highly digitalised business models, and what are the potential implications for value creation?

A.6 The digitalisation of the economy is a process of constant evolution. Please describe how you see business models evolving in the future due to advances in information and communications technology (e.g. Artificial Intelligence, 3D printing).

The questions raised in this section are very business specific. In the time available it has not been possible for us to provide a general view point of our member base on these questions. We welcome

that the OECD have provided some forums for businesses to provide direct input on their business models and the evolution they are going through. We strongly encourage the OECD to continue to keep a dialogue with business on this topic as the tax policy debate evolves.

B. Challenges and Opportunities for Tax Systems

B.1 What issues are you experiencing with the current international taxation framework? (e.g. legal, administrative burden, certainty)

We consider that the work already done by the OECD, has brought about important clarifications and improvements to restrict opportunities for BEPS that some businesses exploited. The main task ahead is for national governments to implement the BEPS recommendations on a consistent basis, including BEPS dispute resolution procedures.

In terms of BEPS implementation so far, businesses have found that there are increased instances of tax controversy. For example, the changes to transfer pricing under Actions 8 – 10 which have been enacted have resulted in many countries trying to assert that value associated with intangibles is created in their country. For businesses that already locate their intangibles and the associated DEMPE (Development, enhancement, maintenance, protection and exploitation) functions in a jurisdiction which taxes these profits, this controversy requires time and attention from businesses to defend against multiple taxation of the same profits. Measures that can avoid similar subjectivity and instances of controversy would be welcomed.

In general, there is significant uncertainty being created for many international businesses because of the rapid changes to taxation that are being introduced by bodies such as the OECD, EU and governments that mean it is hard for businesses to make decisions about investments and transactions with certainty. For instance, the changes to interest deductibility (under Action 4) and CBC reporting require effort, monitoring and additional compliance responsibilities for all large businesses. In the UK, the legislation and guidance on interest deductibility alone runs to hundreds of pages and when this is multiplied by the number of territories that many groups do business in will run to thousands of pages of legislation for them to work through. This is for just one of the BEPS action items. The prospect of further uncertainty for business as a result of continued changes to tax measures is worrying. Restricting the amount of additional change and bringing consistency to any change (e.g. in what the OECD and EU may introduce / recommend) is vital.

SMEs have a particular challenge in complying with a complex and changing tax system, e.g. because they have limited specialist resources internally. Further fast-paced change would be difficult for SMEs to adapt to.

It remains the case that the tax profiles of multinational corporations are not well-understood by a broad range of their stakeholders. Businesses are starting to need to spend more time on compliance requirements to increase transparency, e.g. the UK has introduced a requirement for large businesses to publish a tax strategy. This is another area where real care over the chosen measures (to check they will be fit for purpose) and consistency in country approaches will be important if there are further reporting obligations of this nature introduced.

B.2 Digitalisation raises a number of challenges and opportunities for the current international tax system. In particular:

a) *What are the implications of highly digitalised business models and their value chain on taxation policy? In particular:*

(i) What impact are these business models having on existing tax bases, structures of tax systems and the distribution of taxing rights between countries?

In assessing the impact that business models have on existing tax bases it is very important to consider the full range of taxes that apply across the supply chain. We think that the OECD could helpfully play a role in increasing the understanding of this amongst a broad range of stakeholders.

As an example of the range of taxes that can apply to a digital business model: Collaborative platform models can connect spare capacity and demand, enable individuals to share "access" to assets or access on-demand services efficiently and transparently. The business models of such platforms vary widely, e.g. monetisation through fixed / variable fees, a subscription model, etc. Regardless of the business model, we understand that almost all the value being transferred tends to be between the buyer and seller and remains with the seller. That income, is then subject to personal or business tax. The transaction could also be subject to VAT. The fees charged by the platform tend to represent are a very small portion of the value transferred. These fees may also be subject to VAT. In some sectors of the collaborative economy, there may be additional taxes generated, e.g. tourist tax, excise duties, other local taxes etc. In respect of collaborative platforms, it is also worth noting that they encourage people to make more economic activities visible, instead of conducted as less transparent cash transactions.

VAT is one example where governments have recognised the impact that digitisation has had on their ability to tax the supply of digital goods and services and the BEPS process has been key in addressing this. We discuss some of the practical considerations related to implementation of those changes below based on businesses' experiences.

In comparing digital business models with some more traditional models it may often be considered that the cost base for the digital business model is lower, e.g. less reliance on the high street may reduce their exposure to high property costs. Often, it is the case that the cost base is different rather than necessarily lower. For instance, businesses running an IP platform will have significant IP costs for build and maintenance of the platform. Also, in e-commerce, the storage, delivery and logistics costs that may potentially be incurred under third party service providers to achieve the "last-mile" can be substantial. For certain businesses, who have digitised their product and delivery model, it is the case that these IP costs and an inability to increase revenue (because the customer expects certain features as standard) can squeeze operating margins. It is a general trend, that customer expectations are increasing, e.g. speed of delivery, which creates the need to continually improve services and innovate and this can also squeeze margins.

Accordingly, it is common for there to be low business profits or even losses within new digital businesses until sufficient scale is achieved. It follows that tax measures which would hinder growth and prevent companies reaching this scale, could have a material consequence on competition and the number of businesses who ultimately achieve profitability and the ultimate capacity to pay taxes.

(ii) Are there any specific implications for the taxation of business profits?

To provide an example from one sector, e-commerce has been boosted by consumer's access to the internet and allows retailers to make sales without displaying goods to consumers in a physical shop. The goods may then be delivered to the consumer from another location. As a result, there is a perception that a retailer may no longer need either a shop or warehouse in the jurisdiction of the

consumer to fulfil a sale. Under the traditional notion of PE, such a business may not have a PE in the consumer's country whilst a "bricks and mortar" equivalent would. The perception is that the corporate tax base of the remote sellers can be more readily concentrated in a few number of countries and therefore could be easier to locate in a lower tax country. However, as noted above, customer expectations for speed of delivery are increasing. Therefore, if a retailer does indeed not have storage, delivery and logistics functions in country (either in-house or outsourced to a local third-party provider in country) then they will be at a competitive disadvantage in not being able to meet customer expectations for delivery times.

When it comes to corporate income tax base of a country, this example demonstrates that there is a perception that in this sector traditional retailers may contribute more to the corporate taxes in the consumer's country than digitised equivalents. This creates public perception of inequity in the system and pressure for change. However, that perception may not be aligned with reality.

Also, to reiterate our messages in the previous section, it is important not to forget that corporation tax is just one tax applicable to this business model. For example, the jurisdiction where the consumer is located should still be able to raise indirect taxes, e.g. VAT/GST. The corporation tax model should not be seen to have failed if no corporation tax is due in the location of the consumer because no value is generated there. However, it might mean that countries want to look at their mix of tax revenue and place more reliance on other taxes.

b) What opportunities to improve tax administration services and compliance strategies are created by digital technologies?

A more digitised tax administration could bring benefits to both tax payer and tax administration, for instance, simplification and automation of tax compliance, remote e-filing, more real time working, etc. For businesses, the reality is that these benefits may take a long time to materialise.

The experience is that governments have a limited amount they can invest in IT infrastructure spend. The systems they are developing are not always built effectively for the long term.

There are also concerns that governments are all starting to explore technology independently so the range of different approaches being taken can vary widely. We would encourage governments to work with each other and with business in determining how best to digitise the tax administration and the whole infrastructure that surrounds that. For example, increasingly third-party software providers must be employed and quality standards could be brought in to ensure that the solutions they develop are fit for purpose in considering the tax and regulatory requirements a business must adhere to.

C. Implementation of the BEPS package

C.1 Although still early in the implementation of the BEPS package, how have the various BEPS measures (especially those identified as particularly relevant for the digital economy – i.e. BEPS Actions 3, 6, 7 and 8-10) addressed the BEPS risks and the broader tax challenges raised by digitalisation? Please feel free to support your answers with real life examples illustrating these impacts.

We highlighted above the importance of IP within all businesses. The BEPS package included a number of measures that limited opportunities for avoidance relating to IP, of particular importance were the changes to transfer pricing within Actions 8-10 as well as the anti-hybrid legislation within Action 2.

Once these measures have been adopted widely, there should be minimal opportunities to undertake aggressive tax avoidance and there is evidence that some businesses are already bringing IP activities and profits "on-shore" in response to the legislation that has been introduced (such as Action 2, Actions 8 -10 and CBC reports).

It is very hard at this stage to prove whether significant BEPS risks remain in the international tax system given that tax administrations will not yet have had the opportunity to review tax returns or CBC reports that demonstrate "post-BEPS" results. We are also still at a stage when not all countries have adopted the BEPS recommendations in legislation. For instance, noting Action 2 legislation as a critical development in preventing tax avoidance relating to IP, countries within the EU have until 2020 to introduce the anti-hybrid rules relating to mismatches between the EU and third countries under the Anti-Tax Avoidance Directive (II). Before seeking to introduce new measures, governments should first ensure they are using all of the tools already at their disposal, especially under existing BEPS recommendations.

In a "post-BEPS" environment, we would expect it to be rare for companies to choose to establish DEMPE functions (and accordingly, associated IP profits) in no (or very low) tax jurisdictions. However, it is plausible that this could still occur and it may be for non-tax reasons e.g. where commercial drivers lead to business being done or assets being owned in a low tax jurisdiction.

What is clear from the BEPS implementation process so far, is that there is judgement required in application of many tax rules (for example, in transfer pricing analyses) and this is leading to significantly more tax disputes (for example, over how much value creation originates in each territory). The balance between source and residency taxation is being put under considerable strain by certain countries. Mechanisms to ease such disputes will be very important for business to have access to. Moving forward, we should try to limit the amount of subjectivity or inconsistency in administration of the rules between different countries.

Given the amount of uncertainty and tax controversy that businesses are currently experiencing from the BEPS implementation process we think it is important to allow sufficient time for tax administrations and tax payers to properly work through these reforms before new measures are introduced.

C.2 A growing number of countries have implemented the new guidelines and implementation mechanisms relating to value-added tax (VAT)/ goods and services tax (GST) that were agreed in the BEPS package to level the playing field between domestic and foreign suppliers of intangibles and services. What has been your experience from the implementation of these collection models (e.g. compliance, impact on business operations)? What are some examples of best practice in this area?

A growing number of countries have already implemented new VAT/GST rules to tax digital services provided by foreign suppliers to local customers, and many other countries have announced plans to do so in the near future. Instances where countries aren't adopting the rules, results in complexity for businesses and "sticking" VAT costs in these countries whenever services are invoiced cross-border. It should be encouraged that all countries adopt the changes and do so in a consistent fashion.

Whilst the new rules generally follow the broad framework principles of the OECD's VAT/GST International Guidelines, the huge volume of changes together with the inconsistent implementation of the rules (at a detailed level) into national laws has resulted in a wide variety of legal and administrative practices established by different countries. This brings significant challenges for businesses operating cross border in a globalised economy, even if some governments have tried to implement a simplified system for foreign suppliers – i.e., complying with even simple rules becomes

complex when this is done at scale across many different countries and with great speed. Therefore, we would ask for more international co-ordination to ensure greater consistency and efficiency in addressing what is a global issue. Businesses would also encourage more certainty on the rules at an early stage in their implementation at a national level.

Some of the specific examples provided by businesses on implementation challenges are:

- The collection and validation of tax numbers. In some cases, leading to manual work-arounds needing to be introduced which are resource intensive.

- Increases in IT costs and challenges in resourcing to support with implementation of changes that have a short lead time. This is particularly felt in the case for new invoicing requirements.

- Challenges around determining if you need to register, registering, obtaining and validating customer information needed for the tax determination, producing a 'valid' invoice, and filing and remitting the tax.

- Some businesses have experienced certain countries adding very localised requirements, e.g. the new KSA VAT rules requiring Arabic translation of all invoices, some countries requiring links to specific exchange rate databases or integration with local systems.

  Please refer to the Appendix where we have summarised some areas for improvements that could be made when implementing the BEPS recommendations.

In terms of best practices, businesses have experienced and would recommend the following:

- Critical to success is the implementation of simple and flexible rules in order to encourage growth in the digital economy and, therefore, also maximise tax revenues. In this context, flexibility does not mean promoting inconsistency in the setting of rules, but flexibility in terms of the way businesses can comply and collect the tax due.
- Partnership and consultation with business is key so that appropriate rules can be designed with full understanding of the business context in which they will apply.
- Sufficient lead time should be allowed for both business and tax authorities to prepare for implementation which often requires major organisational changes (people, processes and systems).

  Please refer to the Appendix where we have outlined some comments on particular tax regimes which businesses have experienced.

In line with these recommendations, we would like to highlight the importance of the work on the OECD VAT/GST implementation package. The forthcoming report will be a critical reference point for the consistent implementation of OECD VAT/GST International Guidelines and we would encourage all governments to review the package in detail – those that are considering applying new rules and those that already have rules in place that could be further improved. When considering the implementation guidance, it is important to bear in mind that business models across all industry sectors are constantly evolving and so no one size fits all approach is likely to succeed. Therefore, it is crucial to re-emphasize that addressing the challenges of the digital economy requires the

development of appropriate responses that collect VAT/GST efficiently and effectively without negatively impacting economic growth.

This question (C2) has focussed on whether the new VAT rules have levelled the playing field with regard to domestic and foreign supplies of the same product or service. Whilst a slightly separate point, we would like to note that some businesses are finding that the new VAT rules have created anomalies in treatment of their products (i.e. an unlevel playing field which is not in line with the Ottawa taxation framework conditions on neutrality). E.g. where VAT is now applicable to the "digital version" of their product the consumer is unlikely to be willing to bear this extra cost.

D. Options to address the broader direct tax policy challenges

D.1 The 2015 Report outlined a number of potential options to address the broader direct tax challenges driven by digitalisation. Please identify and describe the specific challenges associated with the application (e.g. implementation, compliance, neutrality) of these options. What are the advantages and disadvantages of these options, including from an administrative and economic perspective, and how might some of the disadvantages be addressed or mitigated through tax policy design? In particular, comments are welcome on the following specific issues:

a) *Tax nexus concept of "significant economic presence":*

A tax nexus based on "significant economic presence", is essentially expansion of the existing treaty definition of a permanent establishment ("PE") to include activity carried on by digital means.

If a digital PE concept would be applicable to all businesses, there would need to be careful consideration of the impact that an expanded PE definition would have on both pure digital businesses (to which transfer pricing principles for profit allocation may not be readily applied) and traditional businesses (who may have an existing PE).

As outlined in our general remarks at the start of this paper, we are of the view that the existing principle that businesses should pay corporation tax where value is created should be respected.

If the concept of a digital PE is further explored, it must be determined in which circumstances an economic presence is established that creates value for the company. Some types of presence in a country, e.g. the pure act of making the sale does not generate the value for the company. Whilst data collection is a common example of perceived value generated at the point of sale, there is great variety in whether and how companies exploit data and therefore what value, if any, raw data has. Further commentary is provided below on data collation and exploitation.

We strongly recommend that a suitable de minimis level is set for a digital PE in order to help manage the compliance burden for business. Whether large or small, businesses may be discouraged from entering new markets or may exit existing markets if the compliance burden is too great.

(i) What transactions should be included within its scope?

The only transactions which should be within scope are those which generate value for the company via the digital PE. That is, it should only capture the value creation which is over and above value created in other parts of the related business that are carried on elsewhere.

(ii) How should the digital presence be measured and determined?

(iii) How could meaningful income be attributed to the significant economic presence and how would such an approach interact with existing transfer pricing rules and profit attribution rules applicable to the traditional permanent establishment?

Conceptually, this option could potentially deliver a new means by which profit is allocated between source and residence countries. In light of the challenges experienced under BEPS Action 7, we think it is incredibly important for the definition of PE and profit allocation to the PE to be considered together.

Delivering this option is reliant on determining a suitable factor (or factors) to define digital presence that goes beyond a mere sale. To us, it doesn't feel appropriate for revenue generation alone to be determinative that a non-resident is participating in the economic life of the source state with a sufficient degree of permanence.

We are unconvinced that data collection can be a suitable secondary (or primary) factor given the knock-on consequences of the use of data collection of profit attribution purposes. Data collection is not a new activity, but one that has been carried out by traditional businesses for a long time. It would be incredibly hard to determine how much value should be attached to data collection. The general view amongst our members is that data collection in its self is not valuable, but it is the analysis and decision making in respect of data that generates value. Accordingly, this value creation would be attached to the location of the people who are analysing and making decisions using the data. This would, therefore, not likely create a very different result to the existing profit attribution position.

If there is a desire to further explore this option, we strongly recommend that more work is done on the factors that in combination could point to a suitable threshold of significant economic presence.

In discussing profit attribution, it is important to note that many highly digitised businesses will be loss-making until they reach sufficient scale. Accordingly, it should be considered whether source countries will be sharing in these losses as well as subsequent profits that may be realised. If not, such businesses may be subject to taxes on profits within the digital PE whilst facing system (i.e. whole supply chain) losses. This is likely to negatively impact their growth.

(iv) How could such a measure be efficiently and effectively implemented in practice?

Once an appropriate presence is established under this method, then it seems logical that implementation would be consistent with the approach to taxation of profits earned by a PE of a "traditional business".

Fundamentally, we would suggest that any changes in the area of a digital PE should be better addressed through transfer pricing. Any future OECD work focussed on a new allocation of taxing rights between source and residence countries, e.g. to give more recognition to the local market would be a departure from the arm's length principle. To avoid a large compliance burden for multi-nationals it would be better delivered via transfer pricing.

If the digital PE option were further explored, we think it is critical for a de-minimis threshold to be included.

In seeking to define a de minimis, some experience can be taken from the Israeli approach. The digital PE concept which has been introduced in Israel only applies where there is already some form of fixed place of business or dependent agent and a "substantial" number of contracts. This is helpful, although

we would recommend that more clarity is given on what “substantial” means in practice as this is not covered in accompanying guidance.

We expect that there would be significantly increased risk of double taxation and tax controversy for businesses under a digital PE concept. For example, for some of the largest businesses we represent who operate in a vast number of countries, there is a prospect that they could have something in the region of 100 digital PEs (depending on exactly how the threshold were set). Each of these could have a different approach to profit attribution. If that were the case, this causes a huge risk of multiple taxation which would be very difficult to resolve via dispute resolution.

It would be helpful to increase capacity and skillset in tax administrations to improve their capability to audit application of these rules for digitised businesses and reduce the potential for tax disputes.

b) Withholding tax on certain types of digital transactions:

In general, the withholding tax looks more like a tax on a transaction than a tax on profit. This exacerbates the potential for double tax, therefore we recommend that this approach is not pursued to the detriment of profit-based solutions.

As noted in the OECD 2015 report, if a withholding tax would lead to domestic and non-resident suppliers of similar products and services to be treated differently there are expected to be significant issues regarding trade obligations and EU law (for example, Hungary’s advertising tax found to be incompatible with State Aid rules).

A withholding tax on a gross basis would apply universally to businesses irrespective of their margins. Setting the rate at a very low level may be able to mitigate some of the downside. However, there may still be a significant detrimental impact on loss-making (or low profit margin) businesses who would not be able to claim a (full) credit. Unfortunately, it seems unfeasible for those withholding the tax to know whether a group is loss-making in order to exclude such companies from the regime. The likely actions businesses could take would then be to pass the cost on to the consumer (if possible) or withdraw from markets. Neither of these are good outcomes for consumers or growth.

It is also very difficult for this sort of tax to be introduced into a Business to Consumer (“B2C”) context, given this would place the compliance obligation on consumers and / or payment processors, card schemes or issuer banks. It is not expected to be easily possible for them to be able to ascertain whether or not the tax is applicable.

(i) What transactions should be included within its scope?

Given the challenges identified above with this option, it is not clear to us what transactions should be included within the scope of this measure.

(ii) How could the negative impacts of gross basis taxation be mitigated?

As mentioned above, gross basis taxation particularly impacts loss-making or low margin businesses. Potentially a repayment mechanism could be designed that would allow such businesses to reclaim tax withheld. This creates a compliance burden for those businesses, but at least would provide an option to have tax repaid.

(iii) How could the threat of double taxation be mitigated?

It is not currently clear whether current tax regimes would allow credit for a withholding tax like this. Accordingly, it would be critical to determine how such a withholding tax could be included within double tax treaties in order to mitigate the risks of double taxation and negative impacts on international trade. It is worth reiterating that even if credit is theoretically available, for loss-making or low profit margin businesses without tax base, off-setting the credit becomes irrelevant.

If explored further, our recommendation would be a globally consistent withholding tax and for it to be made clear how this would fit within the model tax treaty, as there is a substantial risk of failing to achieve credit relief if there is ambiguity or inconsistency in treatment between different countries. It should be in the interest of the source state as much as the residence state for clarity on this matter, so that in practice the split of taxing rights is in-line with expectation.

(iv) How could such a measure be efficiently and effectively implemented in practice?

It is impossible to say how such a measure could be implemented without that measure being defined. There would certainly need to be a transparent mechanism demonstrating how the measure was delivering fairness across consumers, businesses and government revenues.

Presumably it would be necessary to have a digitised system for collection of the taxes. It may fall to third parties, such as payment processors, to administer such systems which squeezes the margins of another business. Governments need to think very carefully about the practicalities and costs involved in introducing such measures into B2C flows.

c) Digital equalisation levy:

In general, an equalisation levy looks more like a tax on a transaction than a tax on profit. This exacerbates the potential for double tax, therefore we recommend that this approach is not pursued to the detriment of profit-based solutions.

If an equalisation levy would lead to domestic and non-resident suppliers of similar products and services to be treated differently there are expected to be significant issues regarding trade obligations and EU law.

As described above in respect of the withholding tax, there is real concern over the feasibility of this type of levy if it were to apply to B2C transactions due to the complexities in administration and collection of the tax. Accordingly, we would recommend that any such equalisation levy is restricted in scope to Business to Business (“B2B”) transactions only. Even with this restriction some challenges would remain (such as risk of double taxation), which are described is sections (ii) and (iii) below.

(i) What transactions should be included within its scope?

Given the challenges identified above with this option, it is not clear to us what transactions should be included within the scope of this measure.

One suggestion could be for a further restriction in scope being that the levy is only applied to transactions where it is considered that the non-resident is not being sufficiently taxed elsewhere on the income. This would need to be carefully targeted at instances where tax avoidance is present. If this were explored further, objective measures should be designed that could be used to identify in which circumstances a levy should be applied to enable consistency in application of such a rule. It is not clear to us whether it would be possible to reach agreement on a globally consistent set of measures.

(ii) How could the negative impacts of gross basis taxation be mitigated?

As described above, a levy applied on a gross basis could be damaging where it applies universally to businesses irrespective of their margins. This can have a significant detrimental impact on loss-making (or low margin) businesses who would not be able to claim a (full) credit.

Our suggestion above to limit this levy to transactions that are otherwise undertaxed would help to limit the impact on loss-making and low-margin businesses.

Also, potentially a repayment mechanism could be designed that would allow such businesses to reclaim tax paid. This creates a compliance burden for those businesses, but at least would provide an option to have tax repaid.

ii) How could the threat of double taxation be mitigated?

It is not currently clear whether current tax regimes would allow credit for an equalisation levy. Accordingly, it would be critical to determine how such a levy can be included within double tax treaties to mitigate the risks of double taxation and negative impacts on international trade (for example, if there were a series of reciprocal levies on imported services this would effectively be a hidden trade tax and could impact business decisions on whether to enter new markets).

It is worth reiterating that even if credit is theoretically available, for loss-making or low profit margin businesses without tax base, off-setting the credit becomes irrelevant. If the costs of operating in a market are too great, likely actions businesses could take would then be to pass the cost on to the consumer (if possible) or withdraw from markets. Neither of these are good outcomes for consumers.

If pursued, our recommendation would be a globally consistent levy and for it to be made clear how this would fit within the model tax treaty, as there is a substantial risk of failing to achieve credit relief if there is ambiguity or inconsistency in treatment between different countries. For example, businesses are experiencing ambiguity in the credit relief position for the Indian equalisation levy. A repeat of this should be avoided.

(iv) How could such a measure be efficiently and effectively implemented in practice?

It is impossible to say how such a measure could be implemented without that measure being defined. There would certainly need to be a transparent mechanism demonstrating how the measure was delivering fairness across consumers, businesses and government revenues.

D.2 A number of other tax measures have been proposed, announced or introduced by various countries that seek to address the direct tax challenges of highly digitalised business models (e.g. diverted profit taxes, new withholding taxes, turnover taxes).

a) What are the advantages and disadvantages of these approaches? Where possible, please share any direct experience from the implementation (e.g. compliance, impact on business operations) of these approaches.

Turnover taxes

We have highlighted above some of the concerns we have with withholding taxes and equalization levies and these would equally apply to the EU proposals for turnover-based taxation, which have been put forward.

The experience of the Indian equalization levy is that costs are passed on to the purchaser of advertising services under contractual agreements. Start-up businesses with less contractual power may not be able to do this, so their profitability would be negatively affected. We expect such unilateral measures would thus hinder competition and international trade.

Some of our members have practical experience of the operation of provincial turnover taxes, e.g. in Argentina (not introduced for reasons of digital business models). The system there includes mandated withholdings from supplier and customer payments. This is not to be recommended as a tax model for the future.

Diverted Profits Tax

A diverted profits tax ("DPT") can create considerable uncertainty for businesses unless it is closely targeted at abusive situations. This is true of the UK DPT which has been introduced.

The UK DPT was originally advertised as a tax targeted at digitized businesses. Whilst capable of applying to digital businesses, it is applicable to all. This wide drafting of the legislation means many businesses are needing to invest time and resource in understanding details of the regime and its interaction with other measures in the wider tax code. It was suggested early on that the legislation would apply only to a handful of cases, e.g. the most egregious avoidance cases. However, we understand there are many cases currently under review given the relatively broad scope of the legislation and subjectivity in its application.

The UK DPT is an example of a unilateral measure that can lead to double taxation. Whether DPT is creditable will vary by country. Unless a jurisdiction has made an explicit statement, there may be uncertainty in ascertaining whether credit is available. There may be knock-on implications, for example, whether mutual agreement procedures are available for disputes relating to DPT. If other countries introduce regimes which are similar to the UK DPT regime, this will further increase the complexity for multinational taxpayers as they grapple with trying to understand the specific rules for each new regime and the interaction with other tax systems of other countries.

b) How might some of disadvantages of these approaches be addressed or mitigated through tax policy design?

More narrowly targeted rules aimed at instances of demonstrable avoidance.

c) What are the specific impacts of these unilateral and uncoordinated approaches on the level of certainty and complexity of international taxation?

In our view, such unilateral measures will have the effect of hindering start-ups to reaching the critical scale that ensures their profitability in the long term.

There are also likely to be more instances of double taxation and tax controversy. Which ultimately, will be damaging to international trade and investment.

Finally, un-coordinated action undoubtedly increases the compliance burden on business meaning resource must be focussed towards managing compliance rather than something else.

E. Other Comments

E.1 Are there any other issues not mentioned above that you would like to see considered by the TFDE as part of its work on taxation and digitalisation?

There is a fundamental need for tax authorities to come to a mutual agreement on the abuse that is being targeted by any measure arising from this initiative, the extent of that abuse and the likely financial impact of those measures on government tax revenues, consumers and businesses before any are implemented.

Those measures need demonstrably to be very targeted to the abuse identified, and measures to avoid double taxation clearly and universally agreed.

Any measures increasing tax take are likely to result in increased cost to consumers and thereby a dampening of the economic growth potential of the digital market place.

Appendix

Experience of VAT/GST regimes

In terms of best practice from states we would highlight the approach of:

The Australian authorities, noting in particular:
- The relatively high threshold implemented in the Australian law, consistent with the existing “domestic” threshold
- The efforts of the Australian authorities to provide clear guidance on the new rules, targeted at different user groups with both high-level and detailed guidance available on the internet
- The significant efforts of the Australian authorities to identify, in advance, foreign businesses likely to be impacted by the rules and to proactively reach out to those businesses directly to highlight the possible impact of the new legislation
- The establishment of dedicated points of contact within the Australian tax authority for foreign businesses likely to be impacted significantly be the new legislation

The EU MOSS scheme, which has the following features:
- Single reporting obligation/registration requirement with the local tax office
- Single payment
- No additional requirement for bank accounts
- A B2C regime only
    - B2B – reverse charge already existed
    - B2B – easy way of validating status via VIES
- Light touch invoicing requirements
- Low value invoicing requirements
- Although, it should be noted that MOSS has no threshold for registration.

The India GST regime, which has the following helpful features:
- Single reporting obligation
- Low Value invoicing threshold

Other parts of the regime are less desirable:
- Multiple rates of GST
- Registration Threshold applied, but was low
- IT readiness
- Very short implementation timelines – 3 weeks for Service Tax implementation
- Government customers not afforded the right to recovery, resulting in sticking Tax

The South African regime, which made no distinction for B2C or B2B.

Suggested improvements to implementing the BEPS VAT recommendations

Clarity on when and how to register:
- B2C regimes only
- Reasonable registration thresholds
- B2B would be subject to
    - Reverse Charge
    - Easy and robust way to verify B2B status

Minimal Invoicing requirements, if required at all. Where required;

- Limiting local requirements, e.g. language, currencies, local tax references, requirements for paper invoices or digital signatures
- Low value invoices / receipts

Electronic

- Registering and filing as many jurisdictions still require paper forms to be completed and paper returns to be filed
- Less frequent filing obligations, quarterly versus monthly
- Allow email correspondence
- People support / out of hours (this was available for a short time in Australia, but no longer exists)

Reasonable periods to file after the period end (e.g. in some countries it is very short at just a matter of days)

Limited or no local agents/representation requirements

Overall, better consultation and improved engagement.

- Improved IT readiness and longer implementation lead times

No "use and enjoyment" provisions