TAX EXECUTIVES INSTITUTE, INC.

2 January 2018

European Commission
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Via online submission

RE: Additional Remarks on "Fair Taxation of the Digital Economy" Consultation

Dear Sir or Madam:

In accordance with the final section of the European Commission's consultation regarding the fair taxation of the digital economy (the Consultation), Tax Executives Institute, Inc. (TEI), submits the following remarks to provide additional context and clarity to its responses to the Consultation's questionnaire.

TEI was founded in 1944 to serve the needs of in-house tax professionals. Today, the organization has 56 chapters around the world, including one in Europe. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting fair tax policy at all levels of government. Our nearly 7,000 members represent 2,800 of the largest companies in Europe, North and South America, and Asia. TEI is included in the EU Interest Representative Register (Register ID number 52413445902-12).

Additional Remarks on the Consultation

Principal Observations

It is neither feasible nor useful to attempt to separate the digital economy from the global economy. The entire economy has been digitalized and any tax policies, even if they are intended to apply only to the "digital" sector, will ultimately apply to the rest of the economy. The options presented in the Consultation questionnaire represent fundamental changes to the global corporate income tax system and will affect all multinational enterprises, whether or not their business activities are wholly or partly digital or digitalized. Consequently, it is inappropriate to address a theoretical digital economy or digital enterprises. It should thus be recognized that any changes will impact all international businesses and the focus should be the development of a sustainable, globally agreed and consistent corporate income tax system that provides certainty and administrability to taxpayers and tax authorities.

Tax policies should promote global economic growth. The tax options under consideration would create significant barriers to entry for all businesses trying to compete in the global marketplace and reduce investment in smaller and developing markets.

Tax should be imposed where value is created. The principles of the OECD's BEPS project, which has benefited from the support of over 100 countries under the project's Inclusive Framework, were built on an intention to ensure taxation is assessed in the country where economic value is created. However, the proposals here discard these agreed principles. The analysis should be focused on economic research, involving all stakeholders, that results in better understanding of evolving business models, to reach consensus on the drivers of value creation, and therefore how the global taxation framework can be adjusted to effectively tax value creation in the appropriate jurisdiction.

Tax policies should be based on principles. The framework set out in the final report under Action 1 of the BEPS Project (*Addressing the Tax Challenges of the Digital Economy*) identified principles of neutrality, efficiency, certainty and simplicity, effectiveness and fairness, flexibility and sustainability, and proportionality, which should guide government tax policy development. The options currently under consideration violate these principles and will discriminate against cross-border business, negatively affecting international investment and development.

It is particularly important that governments and businesses work together to ensure the international tax system remains fit for its purpose as the global economy and technology evolve. It is equally important to guarantee non-discrimination in taxing different business models and TEI believes it is essential that any proposals in this area are agreed internationally through the OECD, and to be implemented (if possible) in a common and coordinated manner at a regional, European, and global level. The potential measures identified in the survey and the Commission's recent publications appear to contradict the spirit of international tax co-operation in this area, and, particularly if pursued unilaterally by the EU, could risk reducing the attractiveness of the EU for foreign direct investment.

Specific Comments on the Consultation's Proposals

As a general comment, we request the European Commission review TEI's response (and other responses) to the OECD's recent request for input on the digitalization of the economy.[1] Many stakeholders with a range of different interests raised a significant number of valid concerns and provided many thoughtful suggestions.

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[1] The OECD's request for input can be found at https://www.oecd.org/tax/tax-policy/tax-challenges-digital-economy-request-for-input.pdf. TEI's submission in response to the OECD's request can be found at https://www.tei.org/sites/default/files/advocacy_pdfs/TEI-Comments-OECD-Request-for-Input-on-Digitalization-Oct122017.pdf.

We also encourage the EU to share its findings and conclusions with the OECD to aid the global discussion in this area. However, in TEI's view, none of the proposals are appropriate without a global agreement to ensure coherency, mechanisms for relief against double taxation, and detailed work on the challenges they would face to ensure compliance with the Ottawa Taxation Framework Conditions,[2] as developed in 1998 and further refined.

Short-term Solutions

TEI opposes temporary solutions because they are disruptive and, because it is always difficult to repeal taxes once in place, they inevitably become incremental taxes and hinder rather than facilitate permanent solutions. Digitalized business models will also continue to evolve at an increasing pace, making temporary solutions no longer "fit for purpose" soon after (or even before) taking effect, so that the cost for tax administrations and taxpayers in developing and implementing short term interim solutions would be difficult to justify in our view.

TEI also has significant concerns about any solution that applies what is claimed to be an "income tax" to revenues or gross payments. Any tax on revenues or gross income will frequently apply in cases in which there is no net income and therefore will hinder global growth and create barriers to entry for start-ups and small to medium sized enterprises (SMEs). Moreover, unless a credit input system is adopted, any tax on revenues would have a cascading effect on business-to-business transactions. If an input credit is granted, then it would essentially replicate a VAT and would therefore be redundant.

Long-term Solutions

The questionnaire suggests five long-term solutions three of which (the CCCTB proposal, the EU directive proposal, and the destination based corporate income tax) would dramatically shift taxing rights from countries in which development and production takes place to countries in which consumption takes place. Because the digital economy is the economy, this shift would apply to all business engaged in cross-border trade and impact the entire world's economy.

Turnover based approaches. Taxes on turnover could cause significant economic damage: such levies target the turnover of digitalized enterprises without a link to either profits or value creation in the jurisdiction where they are levied. While this may or may not be an appropriate policy objective, it is not one that should be described as a corporate income tax as it has no correlation to net income or profits.

Equalization taxes and other levies that tax gross turnover and withholding taxes pose many administrative difficulties, particularly because the obligation can only be imposed on those who have the appropriate knowledge to operate the taxing regime. Thus, consumers, intermediaries, and suppliers would all face challenges in this regard. These taxes would also necessarily hit all businesses: small or large, low- or high-margin, as well as loss-making businesses (such as those investing for growth) disproportionately. Typically, equalization taxes

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[2] *See* Electronic Commerce: Taxation Framework Conditions, *available at* https://www.oecd.org/ctp/consumption/1923256.pdf.

increase the local cost of goods and services. Both withholding taxes and equalization levies would lead to double taxation and significantly inhibit the potential to deliver economic growth of both the digital economy and the digitalized businesses in the broader economy.

As equalization and turnover taxes would be charged, irrespective of the profitability of the enterprise, the effect is likely to be that smaller, growing businesses would be disproportionately affected, while established, much larger MNEs would be able to absorb the additional costs. This, in turn, could help force smaller businesses out of the market, allowing the larger MNEs to take a stronger market dominance and therefore greater opportunity to pass costs on to consumers, so that ultimately consumers could suffer from reduced competition and higher costs.

Nexus based approaches. The introduction of a "significant economic presence" threshold would be a significant departure from the existing rules, and be entirely inconsistent with existing profit attribution rules based upon the value of significant people functions located in a country. The current attribution rules have been the subject of considerable debate in recent years, particularly as the OECD seeks consensus on profit attribution following the changes to the threshold from BEPS Action 7 (*Preventing the Artificial Avoidance of Permanent Establishment Status*). An even more fundamental change to the threshold would result in even greater difficulty in achieving consensus, and result in unilateral interpretations and greater inconsistencies.

Any changes to the nexus threshold and the determination of attributable profits should be dealt with as an entire package, agreed globally, without allowing divergences between countries. Without this coherence, changes regarding the definition of a permanent establishment (PE) will pose significant challenges regarding administration, the allocation of profits, and double taxation.

Altering the PE threshold would result in significant additional administrative cost for both taxpayers and tax administrations, unless there is also recognition of the need for administrative simplification. Proposals that move away from the traditional concept of a PE will increase administrative cost and the need for simplification, as companies with relatively few transactions in a particular jurisdiction could be required to meet considerable compliance obligations that may ultimately drive underlying business decisions, and in particular the decision whether or not to do business in particular jurisdiction.

Other proposals. We do not believe that any of the Commission's other proposals address the concerns raised regarding the allocation of profits to the EU relative to non-EU countries. To avoid arbitrary barriers, which encourage avoidance and distort decisions, such systems would need to be introduced across all industries and geographies. The compliance burden and impact on business, trade, and investment would be significant, particularly if different systems are implemented in different regions.

Conclusion

TEI appreciates the opportunity to provide additional remarks on the EC's *Fair Taxation of the Digital Economy* consultation. These comments were prepared under the aegis of TEI's European Direct Tax Committee, whose Chair is Giles Parsons. If you have any questions about the submission, please contact Mr. Parsons at +44 (0)1455 826561, Parsons_Giles@cat.com, or Benjamin R. Shreck of the Institute's legal staff, at +1 202 464 8353, bshreck@tei.org.

Sincerely yours,
TAX EXECUTIVES INSTITUTE, INC.

Robert L. Howren
International President