MEMO

To : Tax Policy and Statistics Division, Centre for Tax Policy and Administration, OECD
From : Ecommerce Europe
Date : 6 March 2019
Subject : Contribution to the OECD public consultation on addressing the tax challenges of the digitalization of the economy

1. Introduction

Ecommerce Europe is the voice of the European digital commerce sector. Through its 19 national e-commerce associations (the list is available here), Ecommerce Europe represents more than 75,000 companies selling goods and services online to consumers in Europe.

Ecommerce Europe has been advocating against unilateral solutions, at EU and/or national level, from the very beginning of the discussions around the European Commission's intention to introduce a Digital Services Tax (EU DST Proposal). Nevertheless, Ecommerce Europe strongly believes that current international corporate tax rules are not fit for the realities of the modern global economy. However, this is a global issue and it requires a global solution. That is why we strongly support the work at OECD level to address the tax challenges of the digitalization of the economy and we welcome the opportunity to provide our contribution to the OECD public consultation.

Given the high complexity of the topic, the limited time to reply to the OECD public consultation and the fact that the OECD proposals are described at a high level, our contribution to this consultation is also high level, since several elements proposed by the OECD will require further detailed discussion with our members.

2. Main principles

Ecommerce Europe believes that the following principles should be carefully taken into account in the context of the discussions around any (international) tax reform debate.

a) Any tax reform should be pursued internationally at OECD level

In Ecommerce Europe's opinion, unilateral measures - either at EU or national level - will ultimately damage the multilateral order, with potential retaliatory measures from third countries as a consequence. The way taxing rights for multinational companies are apportioned among countries depends on a clear legal system, underpinned by international tax treaties. Taxes imposed outside of this treaty framework can also lead to double taxation or spur protracted tax disputes between countries. Governments should work towards international consensus at OECD level, ensuring a coherent, global, long-term framework for trade and cross-border investments.

b) A fair and modern taxation system must be channel-neutral

Ecommerce Europe agrees with both the OECD's BEPS report and EU experts that have concluded that the wider economy is fast-digitalizing and cannot be "ring-fenced", especially because it is hard to anticipate the future evolution of business models. Thus, Ecommerce Europe strongly supports the idea that changes to international tax rules should apply across all sectors of the economy, not to just a handful of (digital) companies. A successful long-term solution to address the taxation of the evolving international economy must be channel-neutral and thus apply to all businesses, which should be treated equally, regardless of their business model and distribution channel. We consider that it is impossible to define the digital economy, and any concerns with the existing international tax framework result from globalization and the broader digitalization of the wider economy that is occurring. Therefore, we would propose that changes to international tax rules should apply across the entire economy and to all industries.

Until now, corporate taxes have been levied where the value is created. If this has to change, governments should seek consensus on the methodology and degree to which taxation rights should shift to the place of consumption from the place where products and services are created. With narrow definitions and targeted policy instruments, every country could seek to impose new taxes on imported products and services, while maintaining or reducing taxes on exports. Such an unbalanced approach would harm trade, cross-border investments and economic growth.

c) Taxes should be based on profits, not on revenues

Taxes based on revenues have a discriminatory effect on start-ups and growing companies, which invest and often operate at a loss in their growth phase, and on companies in sectors with a high turnover and low margins, such as retail. Moreover, taxes on revenues are typically passed on to consumers. This tends to depress consumption or divert it to other products and services. This has a distortionary effect on economic activity, pushing consumers to buy products and services that might be of lower quality or less efficient. These effects are well-known, which is why revenue-based taxation - on top of existing VAT/GST rules - is typically reserved for products that have well-defined health and environmental consequences, including petrol/diesel, tobacco and alcohol. That is why Ecommerce Europe strongly recommends not to base new tax rules on revenues, but on profits. Taxing profits would also avoid the issue double taxation.

d) Data and digital tools are pervasive and should not be taxed differently

As already said, new tax rules should not “ring-fence” the digital economy. They should not ascribe a different type of value creation to the use of data, customer feedback, or user participation. The wider economy is digital or rapidly digitalizing, which includes the widespread use of data analysis, customer feedback, automated data feeds, computer-mediated transactions, customized products and services, targeted offers, and more. How companies interact with their customers using new technologies should not be the basis for a re-interpretation of corporate tax principles or promotion of a new type of taxation.

e) Tax rules should be simple, easy to administer and provide legal certainty

New tax rules should be designed in such a way that they are easy to comply with and simple to calculate, in order to avoid higher compliance costs for businesses that are already paying their fair share of taxes. The distribution of taxing rights among countries should be clearly defined and not subject to a range of interpretations or assessments. This is needed to avoid costly disputes and excessive compliance costs for taxpayers. The goal of international tax policy should be a predictable tax regime that allows companies operating across borders to make long-term investments. To achieve this certainty for tax authorities and companies alike, we would recommend that any solution that may be adopted includes mandatory binding arbitration as a minimum standard with peer review.

f) Tax rules should be enforceable against all players globally

New tax rules should be globally and easily enforceable, in order to avoid putting non-EU companies in a competitive and unfair advantage vis-à-vis EU businesses. All players should face real consequences for non-compliance or fraud.

3. The OECD approaches

Our current understanding is that the OECD is analyzing different proposed approaches within two key pillars:

- **Pillar 1**: A reallocation of some profit from the country of production to market countries. Proposals within this pillar include (1) user participation proposal, applicable only to social media, search engines and online marketplaces, (2) marketing intangibles proposal applicable to all businesses, (3) significant economic presence proposal, applicable to large digital companies only with profits allocated through formulary apportionment. The proposals could be implemented either through:

    a) Option 1A: Amendments to transfer pricing rules.
    b) Option 1B: Enhanced Nexus. Local market intangible as a market country location asset.

- **Pillar 2:** Minimum Taxation (GILTI / GLOBE + denial of deduction on payments).

1. <u>Pillar 1</u>

➢ <u>Option 1A – Transfer pricing changes for Marketing Intangibles</u>

This proposal would allocate some value to a marketing intangible that is deemed to be created by interaction with or adaptation to local customers in the local market and reallocates an element of non-routine return of the group to the local group entity in those market countries.

This option should be relatively quick to achieve and implement (e.g. because of no changes to tax treaties, fewer changes needed to domestic law, no need to agree on novel international tax concept of profit/loss allocation to jurisdictions where taxpayers do not have a physical presence). It should also be possible to enforce compliance because taxpayers already have a physical presence in a country where they may owe tax.

For the vast majority of countries where an MNE (Multinational Enterprise) has a significant customer base or sales, it is likely that it would also have some form of physical presence in the country, e.g. a sales entity, local distributor, or marketing services provider. Thus, existing transfer pricing guidelines could be adapted for those local entities to more easily update the return allocable to those countries and include a local market return where there is an active local customer or sales base. It is important that the solution is straightforward and reasonable for taxpayers to apply and for tax authorities to audit, thereby promoting certainty and preventing, as much as possible, intercountry disputes and/or multilayer taxation.

We consider that the financial information used to implement this option should be financial data that is readily accessible for both the taxpayer and the tax authority rather than something that needs to be prepared specifically to implement these rules. This could be (1) published and audited global consolidated financial statements, (2) published and audited financial statements by segments, or (3) published and audited financial statements by segment and country.

We would support a simpler approach to allocate a portion of non-routine profits/losses to market countries in order to promote certainty. A highly complex, subjective, business model specific or taxpayer specific approach, would likely lead to a high volume of disputes and double taxation. At a basic level, countries could agree a simplified method to allocate to the market country, an element of the overall consolidated operating profit (or loss), as disclosed in the published accounts, that relates to non-routine marketing returns.

We propose that consideration should be given to the inclusion of *de minimis* thresholds, such that allocation of profits/losses would not be required in countries where a taxpayer generates limited revenues. This would manage the administrative burden on both taxpayers and tax authorities.

We consider it important that where groups are loss-making, any proposal should recognize that the loss is also economically borne by market countries through the allocation methodology.

However, the marketing intangibles model may not treat the tax recipients of the home and market jurisdictions symmetrically in respect to carrying of profits and losses. The model could result in start-up losses being always carried in the home jurisdictions where the business is initially taxed. This could especially be a problem for small export-driven markets with growing tech start-ups, where the main investment is into the centrally developed IP and less so into the local market activities.

To conclude, as a matter of principle, Ecommerce Europe would not support a solution that ring-fences certain digital companies. In our understanding, this would be the case for option (1) user participation proposal, applicable only to social media, search engines and online marketplaces, and option (3) significant economic presence proposal, applicable to large digital companies only with profits allocated through formulary apportionment. On the other hand, the marketing intangibles proposal would be applicable to all businesses and thus it would not ring-fence the digital economy.

➢ <u>Option 1B – Modified Nexus</u>

This option could include a new nexus standard and allocate profit/loss to market countries, including in situations where a group has active customers or sales in a market but does not have a physical presence itself in that market.

We consider that this option presents significant challenges that will make advancing a consensus-based solution in a timely manner very difficult to achieve:

- Expanding taxable presence rules that currently focus entirely on physical presence, to include a concept akin to a “virtual” presence, will require changes to tax treaties and countries’ domestic laws that will take a significant amount of time to agree and develop.
- Governments are likely to have significant difficulty in enforcing the new rules and requiring foreign taxpayers to comply to ensure a level playing field for domestic companies.
- Taxpayers would have a much greater administrative burden. In addition, new systems would need to be built for this purpose only.
- As a practical point, Option 1B will likely require a significant number of changes to Tax Treaties and domestic law and therefore would take a significant amount of time to be implemented.

2. Pillar 2 – Minimum Taxation

This option is understood to have two components: an income inclusion rule for cases involving controlled foreign corporations, as well as an inbound rule that would allow countries to deny deductions for payments (such as interest and royalty payments), which would effectively permit taxation of base eroding outbound payments. Moreover, it seems that the basic idea of minimum taxation is to be fairer with regard to companies and small export-driven countries than the proposals included in Pillar 1.

While addressing base erosion concerns, this option is not a solution that addresses the perceived concern that there is an inability to levy local taxation where there is a material local customer or sales base. It may therefore not be acceptable as a stand-alone global solution.

The recent work by the OECD regarding Base Erosion and Profit Shifting (BEPS), resulted in the adoption of a large number of provisions to protect the tax base of countries. The result of these provisions has yet to be determined and therefore it may be premature to consider a minimum tax until a full impact assessment of the BEPS measures is undertaken.

We also consider that there are substantial technical and practical challenges in implementing this option:

- International consensus would be required around the minimum tax rate to be established and how to calculate the relevant ETR (Effective Tax Rate), and whether certification by a payee country that the payee meets the minimum tax rate would be sufficient.
- It will be difficult (if not impossible) to comply and administer a minimum tax that attempts to recast each payee entities' financial statements into the payer country's tax accounting calculations (e.g. consensus would be needed on the tax base, expense allocation, how losses should be factored in, the impact of income being received in entities benefiting from approved IP regimes under the OECD's nexus approach, etc.).
- Consideration should be given on how to address situations where more than one country's minimum tax is applicable to the same stream of low taxed income.
- It could mean that complex LOB (Limitation on Benefits) provisions of the type that have already been rejected by many countries would be necessary in order to determine the minimum effective tax rate of the payee (and indirect beneficial payees).
- Finally, it might overall increase compliance burdens.

4. Final remarks

Ecommerce Europe strongly supports the EU's ambition to take a leading role in the current debate and looks forward to cooperating with the OECD and continuing constructive discussions to make sure that companies will be taxed in a fair and non-discriminatory way through the adoption of a structural, long-term and global solution.

For any questions or remarks on our contribution, please send an e-mail to lucacassetti@ecommerce-europe.eu.