ICAEW

REPRESENTATION 11/18

FAIR TAXATION OF THE DIGITAL ECONOMY – EUROPEAN COMMISSION QUESTIONNAIRE

Issued 3 February 2018

The European Commission launched a questionnaire on Fair Taxation of the Digital Economy https://ec.europa.eu/info/consultations/fair-taxation-digital-economy_en on 26 October 2017 with a deadline for submission of responses by 3 January 2017.

ICAEW responded to the questionnaire on 19 December 2017 and all the responses will be published on the European Commission website during the first quarter of 2018.

ICAEW also attached a written document to its questionnaire response to expand on the limited amount of space available in the questionnaire to provide responses and the limited nature of some of the questions.

The written document, reproduced below, has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world.

ICAEW is listed in the EU Transparency Register (ID number: 7719382720-34).

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FAIR TAXATION OF THE DIGITAL ECONOMY

Introduction

This supporting document has been prepared by the Institute of Chartered Accountants in England & Wales (ICAEW) to supplement its answers to the European Commission questionnaire on fair taxation of the digital economy.

Is the present questionnaire the best way to get to an appropriate answer?

We are not convinced that multiple choice answers to complex questions are the best means to achieve a better understanding of extremely complex issues, in this case how to achieve fair taxation of the digital economy.

We also believe that a questionnaire "that takes about 20 minutes to complete" as stated in the introduction to the questionnaire, is likely to encourage lobbyists to orchestrate multiple answers to the questions in an attempt to skew the overall response to support their particular point of view.

We are also concerned that the questionnaire seeks to achieve too many objectives at the same time. It is attempting to identify the problem and the potential options and then require respondents to choose between various short term and long term, comprehensive, solutions.

We believe that consultations are better undertaken by way of an iterative process whereby the problem is analysed, the various policy options are identified and examined and then, as a connected but separate exercise, more detailed proposals are explored to determine how best to implement the options that have been chosen.

A reasonable time after any new policies have been in operation there then needs to be a post implementation review in order to gauge the success, or otherwise, of those new policies.

The success and failure of digital businesses

The internet came into being about 50 years ago and the World Wide Web (WWW) some 25 years ago. The digitalisation of the economy began with the WWW.

Google, of which the parent company is now called Alphabet, is still a teenager: it only recently celebrated its 19th birthday: it was founded in 1998.

Other major corporates of the more digital part of the economy include Amazon and Facebook which are 13, Netflix 12 and Twitter 11 years old.

Many of the early 1990s pioneers of the more digital part of the economy failed to sustain their early success and a considerable number went out of business in the dotcom "bust" of 2000.

Current success is no guarantee that it will continue into the future and any major taxation moves need to consider the potential consequences of disruption, and failure, in particular to the smaller and, potentially, more fragile part of this market.

It is also worth considering whether imposing extra taxes on particular ways of doing business may discourage innovation and risk taking when there is a need for greater productivity in all the economies of the world.

Nevertheless today's digital part of the market place is characterised by some hugely successful digital businesses which are dominant in their part of that market place eg : online advertising – Google; movies – Netflix; retail – Amazon & ebay; travel – Priceline, Expedia & Booking.com; consumer asset sharing – Airbnb, Uber & Lyft.

There is a public concern that some of these successful businesses are not making a sufficient contribution to the public finances by way of taxation on their profits. To take just one recent example the lead editorial in the Financial Times on 13 October 2017, explaining how Netflix and eBay minimise their UK tax liability, concludes "the current system is manifestly unsatisfactory".

The different business models

The European Commission Communication to the European Parliament and the Council on "A fair and efficient tax system in the EU for the Digital Single Market", published on 21 September 2017, puts forward four examples of the currently recognised new ways of doing business, while accepting that its list is non-exhaustive:

> **Online retailer model**, whereby online platforms sell goods or connect buyers and sellers in return for a transaction or placement fee or a commission. Examples of businesses include Amazon, Zalando, Alibaba.
>
> **Social media model**, whereby network owners rely on advertising revenues by delivering targeted marketing messages to consumers. Examples of businesses include Facebook, Xing, Qzone.
>
> **Subscription model**, whereby platforms charge subscription fee for continued access to a digital service (e.g. music or videos). Examples of businesses include Netflix, Spotify, iQiyi.
>
> **Collaborative platform model**, whereby digital platforms connect spare capacity and demand,use reputational currency mechanisms to underpin consumption, and enable individuals to share "access" to assets rather than own them outright. Platforms charge a fixed or variable fee on each transaction. Examples of businesses include Airbnb, Blablacar, Didi Chuxing.

The analysis in the more recent UK government position paper *Corporate tax and the digital economy* analyses the businesses that exploit digital opportunities through the nature of their relationship with customers. This is set out as follows:

- businesses that build a user base on an online service, and then generate revenues through directing adverts at that user base which are targeted more precisely through personal data derived from the systematic monitoring of users' activities e.g. a search engine
- businesses that build a user base on an online platform that allows for the sharing of content and user-generated contributions, and then generate revenues through directing

adverts at that user base which are targeted more precisely through personal data derived from the systematic monitoring of users' activities e.g. a social media or file-sharing platform

- businesses that provide an online marketplace for buyers and sellers of goods/services and take a commission from the resulting transactions
- businesses that build up a user base on an online platform and then take a commission from matching users' common interests e.g. exchanging of goods, renting of assets, and forming of relationships

With many companies operating a number of distinct business models within their own businesses this demonstrates how difficult it is going to be to design any additional taxation mechanisms to do justice to the variety of digital business models: the attempt could prove as doomed to failure as Sisyphus pushing his boulder up a hill in Greek Mythology.

Challenges and opportunities for tax systems

It is undoubtedly true that digital is likely to continue to be an increasing part of national economies, and of the global economy. There are legitimate concerns that the existing (and future) business models are sufficiently different from those of the past for the current national, and international, tax systems to have great difficulty in taxing them in a way which supports the public finances and addresses public concerns to ensure that all significant participants in the global economy pay what might be considered to be their "fair share" of tax.

Policy makers need also to recognise that many countries have refashioned their tax systems in recent years, not least to recognise the difficulty of identifying and taxing profits, and have increased the taxation of, for instance, labour, property and sales (VAT). In the UK the annual studies of PwC into the tax borne by the largest UK businesses have shown a decline in corporate income tax from 50% of taxes borne, just over ten years ago, to less than 20% in the 2016 report. This has risen to 25% in the latest, 2017, report because of increased taxation of the UK banking sector.

This has not overturned the complaints, particularly vocal in the UK, that international businesses are in a better position to take advantage of faults in the existing tax regime to pay less tax than their purely domestically based competitors.

Particular proposals in the questionnaire – ICAEW comments

A tax on revenues (or a withholding tax) is not a fair way to tax the value generated by an online business. In the long run, the value of a business is dependent on the profits it generates rather than its revenues. A revenue-based tax results in a loss-making business paying the same level of tax as a profitable business with the same turnover. It will penalise and deter new start-ups from offering services to EU markets, to the disadvantage of consumers. Further, it will lead to double taxation to the extent that these companies are paying tax on their profits in the countries where they are based.

We would expect that such taxes will be outside the scope of the many double tax treaties EU member states have negotiated with other countries. However, taking unilateral action in international tax matters risks inviting retaliatory responses from other countries. Although the companies that come to mind first when considering the digital economy may be American, there are of course some very large EU businesses with an extensive online presence. It would be troubling if other countries decide to impose similar revenue-based taxes on EU groups. Unless the EU wishes companies in the digital economy to suffer an overall higher level of taxation, it would be necessary to allow double tax relief for any such foreign taxes. Doing so would of course effectively reduce the tax take to EU member states and therefore there can be no certainty that the introduction of new taxes would result in a long term increase in tax revenues.

The concept of a digital transaction tax, related to the gathering of user data, where there may be no financial transaction, needs to be elaborated in more detail. However, it seems likely to deter new and innovative business models that may be provided free at the point of use to consumers.

The OECD BEPS Action Plan

When the final BEPS reports were published in late 2015 the Action 1 report on the Digital Economy noted that the other measures would go a considerable way to addressing the potential lack of taxation of the digital part of the economy.

The OECD Secretary General's Report to the G20 Summit in July 2017 included, as Annex 1, a Progress Report on the Inclusive Framework on BEPS, July 2016 to June 2017. At page 24 it stated:

> "There was clear agreement [in the final BEPS 2015 report on the Digital Economy] that the consistent and widespread implementation of the BEPS package would address many of the double non-taxation concerns raised by digitalisation."

OECD is now in the process of finalising an interim report to be presented to the meeting of the G20 in April 2018. We consider that any longer term options identified by the EU will only be successful if they receive broad international acceptance through recommendation from the OECD and other international organisations and then implementation in the major economies in the world. We are concerned that if the EU were to take unilateral action this will lead to an incoherent international tax system and risk retaliation from other countries.

US tax reform

The current proposals have been put forward at a time when it seems more likely than ever that the US will reform its tax system, in the process taxing the accrued foreign profits of the US tech giants that have so far enjoyed a low level of taxation. Furthermore, as we have stated above, the BEPS reforms have only recently been implemented and should be given a chance to succeed before any conclusion should be reached that they are not adequate. Further changes to the taxation of the digital economy may prove to be largely unnecessary.

How to address the broader direct tax policy challenges of the digitalised economy?

There needs to be more analysis of the nature of the most successful digitalised business models which are the subject of adverse public comments and which have the greatest impact on the public finances of individual countries.

Only on the basis of a detailed analysis of current digital business models should new tax policies be put forward by the European Commission and other International Organisations.

We think there should be a substantial threshold before any new measures come into operation, for instance in France for the You-tube tax the threshold is €100k per year, so that only the largest highly digitalised businesses are potentially "caught" by such measures.

Such provisions need to ensure they do not breach, for instance, EU non-discrimination rules.

There should be appropriate exemption mechanisms so that if tax is paid under such new measures there will be appropriate exemption to avoid the risk of double taxation.

ICAEW Tax Faculty
December 2018