



## CORPORATE TAX AND THE DIGITAL ECONOMY

Issued 2 February 2018

ICAEW welcomes the opportunity to comment on the position paper [Corporate Tax and the Digital Economy](#) published by HM Treasury on 22 November 2017.

This response of 2 February 2018 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. Appendix 2 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

We should be happy to discuss any aspect of our comments and to take part in all further discussion and consultations on this area.

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## INTRODUCTION

1. We welcome the publication of the current position paper Corporate Tax and the Digital Economy which provides a valuable insight into the UK Government's thinking on these tax issues and identifies where it might be appropriate to modify the existing tax regime.
2. Digitalisation has made significant changes to the way national, and international, businesses operate and are run.
3. The new ways of conducting business do not fit easily within the current, national and international, tax regimes and this has created significant tax problems.

### Other recent consultations by international organisations

4. The position paper has taken into account the feedback to the recent OECD consultation Addressing the tax challenges of the digital economy which will inform the OECD interim report to be presented to the G20 Finance Ministers' meeting in April 2018.
5. The European Commission has also been carrying out work into Fair taxation of the digital economy via a questionnaire which closed for comment on 3 January 2018.
6. ICAEW Tax Faculty has responded to both the OECD consultation and the European Commission questionnaire.

## THE ICAEW VIEW

7. The appropriate taxation of the digitalised economy poses one of the most difficult questions for the tax world, not least because of the enormous importance and success of the very large digitalised businesses.
8. The OECD BEPS Action Plan has helped to provide solutions to many of the problems posed by the digitalised economy and any further action needs to take into account all the BEPS work which is still continuing.
9. Whatever further changes are made to the existing national, or international, tax systems need to be based on collaboration and coordination between countries. Longer term solutions based on international consensus will be much more satisfactory, and sustainable, than short term approaches and unilateral action.
10. In the UK we face considerable challenges not only from the digitalised economy but also from Brexit and the moves to digitalise tax systems: all of these challenges suggest that caution needs to be exercised before any further, fundamental, changes are introduced to the UK tax system.

## THE EVOLUTION OF BUSINESS – THE BACKGROUND TO THE CURRENT POSITION PAPER

11. The digitalisation of the international, and domestic, economies poses considerable challenges for the current taxation system and to the current allocation of taxing rights between countries for which the broad principles were laid down nearly 100 years ago.
12. In today's global world business is increasingly transacted electronically and without recourse to geographical locations and the value which underpins any particular transaction is increasingly determined by the related intellectual property rather than the intrinsic nature of any physical product. Intellectual property is made up of a number of elements which could include the value of the seller's brand, but can equally well include knowledge about the customer base. The buyer and seller will often be in different jurisdictions, while there may also be an intermediary platform facilitating the business.

13. The current tax arrangements still seek to tax profits by reference to the residence of the “owner” of those profits unless taxing rights can be allocated to a source of those profits in a different jurisdiction.
14. There is concern that international groups can arrange their intra group trading and their corporate structures such that profits end up in lower taxed jurisdictions. The transfer pricing rules are under threat despite continuous upgrading to the OECD Transfer Pricing Guidelines first published in the mid 1990s.
15. The OECD Base Erosion Profit Shifting (BEPS) Action Plan, which was published at the end of 2015, after an intensive two year period of global debate, will provide answers to many of the inadequacies of the current national/international tax regimes. This work is continuing particularly in relation to transfer pricing issues.
16. It is likely that some of the concerns about under-taxation will be addressed by the US tax reforms agreed at the end of 2017. It is currently not at all clear how the reforms will impact business behaviour but the BEAT (Base Erosion Anti-Abuse) and the GILTI (Global Intangible Low-Taxed Income) proposals may have a significant impact on digital businesses identified in the present paper. However, some of the impact may depend on the particular facts and circumstances of individual groups. The HM Treasury position paper states at paragraph 5.14:

“The government will continue to monitor the progress of US tax reform. However, while those reforms might help to address the concerns raised in this paper regarding non-taxed intellectual property-related income, they will not address the more fundamental concerns about the failure of the international tax regime to align profits with value creation in certain digital businesses.”

## HM TREASURY POSITION PAPER

17. The position paper sets out the underlying principle which should determine how global businesses are taxed:

“a multinational group’s profits should be taxed in the countries in which it generates its value.”

18. The UK government is committed to supporting the continued growth and success of the UK tech sector and the position paper acknowledges the benefits that digital businesses provide in enhancing consumer choice and supporting productivity.

### The challenge:

19. The challenge set out in the position paper is that:

“.... the international corporate tax rules [should] ensure that [digital businesses’] UK corporation tax payments are commensurate with the value they generate from the UK market and specifically the participation of UK users.”

20. It will also be necessary to work out what this value is and how to measure it.

### The HM Treasury proposals

21. The proposals to deal with the challenge are:

#### **Long term reform (paragraphs 4.1 to 4.7 of the position paper)**

The government will push for reforms to the international tax framework, to ensure

that the value created by the participation of users in certain digital businesses is recognised in determining where those businesses' profits are subject to tax

**Interim digital solutions (paragraphs 4.8 to 4.12 of the position paper)**

Pending reform of the international framework, the government will explore interim options to raise revenue from digital businesses that generate value from UK users, such as a tax on revenues that these businesses derive from the UK market. The UK will work with other countries to consider how such a tax could be targeted, designed and co-ordinated to minimise business burdens and distortion. However, the government stands ready to take unilateral action in the absence of sufficient progress on multilateral solutions

**Preventing under-taxation (paragraphs 4.13 of the position paper)**

The government will take more immediate action against multinational groups, primarily in the digital sector, who achieve low-tax outcomes by holding their valuable intangible assets such as intellectual property in low-tax countries where they have limited economic substance. This action, which is taken in accordance with the UK's international treaty obligations, will help to prevent groups achieving unfair competitive advantages in the UK market in which they operate. It will also help to ensure that the discussion on how value is created by the users of certain digital businesses starts from a more sustainable position

**ICAEW – GENERAL COMMENTS**

22. A much deeper understanding of the different components of user-generated value, and how to measure this, is required before bringing forward proposals to tax it. We are sceptical about the proposition that a unique kind of value is created by users of, for example, social media sites. It is possible that some of the profits arising should be taxed in the territories where the users are located, but before this can be taken forward, we need a better understanding of what these profits are and then to have international agreement on their nature and value measurement.

**LONG TERM REFORM**

23. The position paper recognises that the long term solution will require multilateral reforms through the work of OECD amongst others and looks to the OECD, in its interim report of April 2018, to outline a multilateral process by which such issues can be resolved.
24. This will require an evaluation of the value/profit created by a material and active user base in a particular country, even in the absence of a permanent establishment in the currently accepted definition of that term, and a means of allocating profit to the countries where there is that user base by reference to “a metric that approaches the value that the user base generates e.g. monthly active users”.
25. This could be seen as trying to define a digital equivalent of a permanent establishment and finding suitable metrics to attribute value/profit to that digital PE.
26. This will require informed debate by countries and business to ensure the underlying business models have been properly understood and that the metrics identified are suitably flexible, sustainable and robust.

**ICAEW comments on the long term reform proposals**

27. We appreciate the difficulties faced by policymakers in this area but can see a number of difficulties in determining taxable value in such circumstances. When users provide content or data to an internet platform, that does not necessarily have value or that value

may only be “realised” when it is aggregated in an appropriate way. Using a proxy for value creation, such as monthly active users, is going to be far from straightforward as the value of each user’s contribution is going to vary considerably between businesses and possibly also with the same business over time. Maintaining the value of the platform may depend as much on the development of the underlying technology as on the intrinsic value of the data etc provided by the users.

## INTERIM DIGITAL SOLUTIONS

28. The position paper recognises that the long term reform proposals, discussed in the previous section, will potentially provide the most sustainable and comprehensive solution to the appropriate taxation of the digital economy.
29. But the position paper also accepts the view of the European Commission and other EU member states that there is a need for an interim solution.
30. Of such interim solutions the government believes that the most attractive option is “a tax on the revenues that a business generates from the provision of digital services to the UK market”.
31. This is considered to be most appropriate in relation to
  - a **social media platform** that generates revenue through directing adverts at UK users who use a free online platform or
  - an **online marketplace** that generates revenue through matching suppliers and purchasers of goods in return for a commission or
  - a **collaborative platform** that charges a commission for bringing together supply and demand for assets and possessions owned by individuals.
32. The two latter models are said to generate revenues through “intermediation” (paragraph 4.10 of the position paper).
33. The position paper specifically states, paragraph 4.10, that some business models do not cause concerns for the existing taxing arrangements:

“The concern seems less relevant to businesses that generate revenue through selling self- developed goods to customers through an online platform, selling acquired goods on an online platform, charging customers for the provision of digital content, or charging customers for the provision of digital software and digital services.”
34. We think this statement needs to be tested. There can still be added value through targeting of customers. Take the example of Spotify. Spotify examines what you stream and then will suggest other music with a purchase option. Spotify is a Swedish company but users are international. When the points made in the position paper, and the feedback, are taken forward there should be an attempt to develop generic rules for determining value rather than a focus on a limited number of digital businesses which are deemed to be undermining the existing tax regime.
35. The position paper then sets out various considerations including nexus, rate of taxation, collection mechanism and the detailed design of an effective system but states that action in this area would also benefit from co-ordinated implementation and believes that the forthcoming April 2018 interim report of the OECD “should actively consider” these issues. We agree.

36. The interim digital solution is discussed at paragraphs 4.8 to 4.12 of the position paper and there is a further discussion in chapter 5, paragraphs 5.4 to 5.10, about the sort of businesses that might fall within the Interim digital solution which are described in paragraph 5.5. And there is a concern, expressed at paragraph 5.19, that

“an important consideration with the design of any interim measure would be ensuring that the UK remains a competitive place to do business. We would welcome feedback from stakeholders about how this can be best achieved.”

#### **ICAEW comments on the interim solutions**

37. We accept that interim solutions will raise similar issues to those we have identified in relation to the long term solution proposals.
38. There are no easy answers but in order to try and reach some consensus on proposals for reform a number of issues will need to be debated beforehand.
39. Even if it is agreed as a general principle that a UK user base is involved in the creation of value, a tax on revenues while attractive on the grounds of simplicity is not likely to be a fair way to tax the value generated by such activity. In particular, it could penalise and deter new start-ups from offering services to UK consumers (and such businesses are especially crucial in this sector).
40. We think that the concept of value added by the customer base may provide a more sustainable and fairer way to arrive at taxable value.
41. We believe there are problems with the boundaries of the proposed tax. We believe that it will be difficult to draft legislation that draws a line between the types of business the government wishes to tax and others. For example, the line between social media and traditional media looks increasingly blurred.
42. While we accept that unilateral actions, such as the introduction of Diverted Profits Tax, may be justified in the context of tax avoidance, it is less easy to justify such action where the perceived problem is an integral feature of the international tax framework.
43. The issue that the position paper seeks to address is to ensure that some tax is captured at the place of delivery of a service. We consider that VAT is the appropriate tool for this job, rather than a new tax on revenues.
44. The key proposition that the position paper seeks to address is to ensure that some tax is captured at the place of delivery of a service. We can understand why that proposition is attractive, although implementation of it is likely to be much more difficult to achieve. If this proposition is accepted, however, then we would suggest that the appropriate tool to address it should be through the existing VAT system rather than a new tax on revenues.
45. We accept that some digital businesses have a different, more intimate and iterative, relationship with their customers/users and this may be a principled reason to identify those businesses for a special, interim, solution, but to do so without a sound basis for attributing the value to be taxed and to a single part of this complex marketplace without a suitable roadmap is not, in our view, a sustainable solution. This will give rise to definitional difficulties and the need to ensure that any measures do not deter new potential entrants into a particular part of the market place.
46. We believe there needs to be much more careful analysis of the proposition, and discussion with business, before any precise interim solution can be put forward.



## **PREVENTING UNDER-TAXATION**

47. The government discusses this proposal in the position paper but it subsequently published a consultation document on 1 December 2017 Royalties withholding tax for comment by 23 February 2018.
48. We will be submitting a separate Representation on the Consultation before the deadline of 23 February and are not commenting further on that proposal in the current paper.



## APPENDIX 1

### The recent OECD work on addressing international tax problems

We have set out below an overview of recent work by OECD in recalibrating the existing tax regime which provides a context to the current HM Treasury position paper.

### The beginnings of a new world tax system –the OECD BEPS Action Plan and what it will mean in practice

The international community confronted challenges to the existing tax arrangements in the OECD BEPS Action Plan which was officially launched by the G20 at the Summit in St Petersburg in September 2013.

In late 2015 OECD published the “final” reports from that initial Action Plan work and these were endorsed by the G20.

The OECD BEPS Action Plan set out a number of minimum standards so that although OECD has no legal right to enforce compliance with its proposals the fact that countries have all agreed collectively that they will change their domestic law means that those minimum standards have, de facto, the force of law.

There was certainly not total agreement amongst the countries involved in the BEPS Action Plan and some of the “proposals” that have been agreed to are best practices or recommendations rather than minimum standards and so not mandatory. But there are now, January 2018, 110 countries which have become members of the OECD Inclusive Framework and have each signed up to put into effect the minimum standards and take into account the recommendations and best practices which are spelt out in the Action Plan.

OECD has, since 2015, continuously emphasised that its subsequent work is about the implementation of the Action Plan. A number of peer review programmes are being put in place to ensure that countries that have signed up put into place the necessary measures to give effect to those minimum standards.

The de facto outcome is that some consensus has been built up amongst the world’s economies and the recognition that the BEPS measures will go some way to address the double non-taxation concerns raised by digitalisation.

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.”

The current proposals of the UK government need to be viewed with that in mind.

### OECD BEPS Action Plan – Minimum Standards

There are four minimum standards which more than 110 countries have signed up to as members of the OECD BEPS Inclusive Framework. OECD is setting up peer review arrangements for all of these four minimum standards to ensure that individual countries comply with the standards and are seen to be doing so.

The four minimum standards are in relation to:

### **Harmful tax practices**

The OECD is carrying out a review of preferential tax regimes to ensure they are not harmful and OECD has set up a transparency framework which will apply to tax rulings.

### **Treaty abuse**

Countries will ensure that taxpayers cannot take advantage of double tax treaty benefits to which they are not entitled and there is also a Multilateral Treaty which will ensure that the provisions of bilateral treaties are updated to incorporate the relevant treaty provisions which will reduce the risk of treaty abuse.

### **Country by country (CbC) reporting**

The objective of the CbC report will be to provide tax administrations with a high level overview of the operations and tax risk profile of the largest multinational enterprise groups (MNE Groups).

CbC reporting applies to MNE Groups with annual consolidated group revenue of €750 million or more (or near equivalent in local currency) in the immediately preceding fiscal year.

### **Dispute resolution**

There has been a real concern that reconfiguring the international tax system, and making some elements more subjective, will lead to more disputes between countries. The BEPS Action Plan put in place rules, and review processes, to ensure that there is a more robust system to review and resolve any individual disputes.

## APPENDIX 2

### ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see <http://www.icaew.com/-/media/corporate/files/technical/tax/tax-news/taxguides/taxguide-0499.ashx>).