



ADDRESSING THE TAX CHALLENGES OF THE DIGITALISED ECONOMY

Issued 6 March 2019

ICAEW welcomes the opportunity to respond to the Addressing the tax Challenges of the digitalised economy consultation <https://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf> published by OECD on 13 February 2019.

This response of 6 March 2019 has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business. ICAEW Tax Faculty's Ten Tenets for a Better Tax System are summarised in Appendix 1.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 150,000 chartered accountant members in over 160 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

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KEY POINTS

1. ICAEW believes that there need to be clear principles that underpin the taxation of all business and, in particular, international business.
2. In the absence of clear principles there is a risk that business will be subject to multiple taxation and there is likely to be an increased level of disputes involving the countries in which those businesses operate to determine appropriate taxing rights.
3. There is also a risk, in the absence of clear principles, of double non taxation. Some international businesses will not make an appropriate contribution to the public finances of all the countries in which they operate.

THE OECD PUBLIC CONSULTATION DOCUMENT

4. The public consultation document, issued on 13 February 2019 for comment by 6 March 2019, has been published by the countries comprising the OECD Inclusive Framework on BEPS. It is not a consensus document but is intended to elicit input from outside bodies such as ICAEW Tax Faculty on the issues raised in the consultation document.
5. The public consultation document has been published in advance of a public meeting in Paris on 13 – 14 March to discuss the issues raised in the consultation document.
6. After the public meeting there will be a follow-up OECD report to the G20 prior to the G20 Summit meeting in June 2019 in Japan.
7. The overall objective of this OECD work is that there should be a final conclusion and report by the end of 2020 which will command the support of the 128 countries in the OECD Inclusive Framework.
8. A key objective for that final report is to create a sustainable international tax framework which will address the challenges posed for tax systems by the digitalisation of domestic economies and the international economy.
9. OECD is currently working on the basis that it will put forward final proposals, a solution, before the end of 2020. These proposals will be put to the G20 at its 2020 summit in Saudi Arabia or at some other appropriate time before the end of that year.

THE BROAD OUTLINE OF THE LATEST OECD POSITION

10. The current OECD position, as outlined in the current consultation document, has two main Pillars.
11. Pillar 1 contains three proposals one of which is a “user participation” proposal modelled on the UK Digital Services Tax which has been the subject of a recent consultation which finished on 28 February 2019.
12. The second proposal is a “marketing intangibles” proposal which has the support of a number of other countries and would be a more general proposal, not restricted to highly digitalised businesses.
13. The third proposal is for a digitalised permanent establishment but this proposal has not been fully formulated in the most recent OECD consultation document.
14. Pillar 2 is a mixture of a minimum taxation of targeted businesses and a restriction on base eroding payments.
15. The consultation document poses a small number of broad based questions in relation to each of the two Pillars in paragraph 87 and 110 respectively. We have not commented specifically in relation to these questions but have raised more general issues which we believe are relevant to the proposals under each of the two Pillars.

GENERAL COMMENTS

An indication of the problem

16. One of the big problems for the existing tax regime, posed by new business models emerging in the digitalised economy, is that the initial, potential, creator of value is often a barter transaction which does not fit within the existing international tax architecture.
17. If a user of an internet platform provides personal details, data, on the internet platform that, arguably, may have little intrinsic value. We do, however, appreciate that there are some valuation models which do believe that some value can be attributed to that data contribution. But a more major value generator arises if the internet platform is able to aggregate similar data from literally millions of users so that the aggregate data can be monetised, for instance by allowing advertisers to target the particular users most likely to be interested in their products or services. In that way the platform can make money as a result of the users' initial interaction with the platform.
18. This is one element of the "user participation" proposal which is the first proposal under Pillar 1 in the OECD consultation.
19. There is value, and potentially profit, further down the interaction chain but how do you best recognise any initial value created by the first user of the platform and in which country do you seek to levy tax?
20. The traditional transfer pricing approach is to determine a market based transfer price to affix to a particular transaction. This does not work when there is limited value at the time that the raw data is uploaded to the internet platform in return for use of the platform.
21. It is the aggregation of raw data which creates the market opportunity which is monetised by the platform so that advertisers target the relevant data providers most likely to be interested in their product or service in return for a payment to the platform.

Clear principles need to underpin any change in international taxation

22. We fully support the underlying approach put forward by Business at OECD, in their own submission, that there needs to be a broad consensus between the Inclusive Framework countries if any fundamental change to the existing international tax regime is going to be sustainable and create the certainty that business requires.
23. In the words of the Business at OECD submission "there needs to be broad and deep agreement between countries".
24. In order to achieve this ICAEW believes that there need to be clear principles to underpin any new proposals to ensure that multiple taxation is avoided and the change does not increase the number of disputes between countries as to appropriate taxing rights.
25. The UK Parliament Treasury Select Committee set out in its 2011 report Principles of tax policy <https://publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/753/753.pdf> some key basic principles that it believed should underpin any tax, new or existing. The basic principles are fairness and economic welfare and that any tax should support economic growth. There are then some more procedural principles which are certainty, stability and practicability.
26. These principles are drawn from ICAEW Tax Faculty's own Ten Tenets Towards a Better Tax System which are reproduced in Appendix 1 and which were first promulgated at the time that OECD elaborated its own principles in the light of the challenges posed by electronic commerce towards the end of the 1990s. The Ottawa Taxation Framework Principles <https://www.oecd.org/ctp/consumption/1923256.pdf> delineated seven key principles which should underpin any tax system:
 - Neutrality;
 - Efficiency;
 - Certainty;
 - Simplicity;
 - Effectiveness

- Fairness; and
- Flexibility.

Business can also make losses

27. The identified problem is that some very large multinational businesses make very considerable profits but have a sufficiently light footprint in many countries in which they operate so that they avoid any potential taxation in those countries.
28. Nexus and profit attribution is a key part of the OECD consultation but some multinational businesses may not make profits or not make profits in all the countries in which they operate.
29. Any new nexus and profit allocation regime needs to recognise the potential existence of losses and make sure that appropriate measures are in place.

Dispute resolution

30. OECD recognised the importance of enhanced dispute resolution arrangements in the initial BEPS Action Plan and Action 14 was designed to make dispute resolution mechanisms more effective. This is one of the minimum standards which has emerged from the BEPS work.
31. BEPS did not seek to undermine the historical approach to international taxation but the current work seeks to amend that approach.
32. For this reason it is absolutely vital that dispute resolution mechanisms need to be adapted so that they are more robust and can address new challenges to the international tax regime. We recommend that the BEPS minimum standard regime should be reassessed in the light of the latest challenges posed by the digitalisation of the economy and the current peer review procedures may also need to be reassessed.
33. If profits and also losses of multinational groups are to be allocated across various countries in accordance with new locus and allocation rules then a strong mechanism for handling potential cross border disputes is going to be absolutely essential.

APPENDIX 1

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 <https://goo.gl/x6UjJ5>).