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Statement of the German Association of Tax Advisers (DStV) for the Tax Governance Platform Meeting of the DG TAXUD at 18.October 2017

General Remarks:

At this early stage of the debate the initiatives at EU level targeting the challenges of taxation of the digital economy are too broad to draft final or conclusive positions on behalf of the German Association of Tax Advisers.
The scope and definition of “digital economy” is unclear. A first step in the EU initiative must be to clearly define the target and problem it seeks to address.

Thus far, three kinds of economy can be grouped: classical industrial economy (production of tangible goods and physical presence), a hybrid economy which has features of both, industrial economy and digital economy (i.e. software, digital services) and highly digitalized economy (i.e. only operating in the virtual sphere).

At this point of time only hybrid undertakings and highly digitalized economies qualify as digital economy. Thus, before adopting measures or techniques of taxation the scope and definition of digital economy must be clarified.
For example, hybrid undertakings, which are undertakings that rely on digitalization and new technologies but still sell products or tangible goods, which use the international tax framework to avail taxation and maximize profit (i.e. Apple). This is a problem which is, in principle, dealt with by BEPS initiatives. However, in the broad sense of digital economy, undertakings like Apple would also come within the scope of the digital economy.

This is different for highly digitalized business models where undertakings offer services from one country in another Member State without physical presence (Google, Facebook etc.). This new business models take away the tax base – the principle of establishment – which is used for the taxation of the “classical economy”.

Thus, clarification is needed which economy (classical, hybrid or highly digitalized), which economic activity and at which scale the digital economy (EU or non-EU) is targeted.

1. What issue do you see with the current international tax framework vis-à-vis the digitalized economy?

The key problem is that the digital economy or at least the highly digitalized economy does not, by the very nature of their economic activity, come within the scope of the existing international tax framework.

The current international tax framework does not effectively grasp the specificities of the digital economy and in particular the development of highly digitalized business models which lack the classical tax base – physical presence. With the digitalization and new business models, physical presence is no longer required to generate profit in another Member State.

The Digital Economy relies heavily on alternative and highly digitalized business models. Services are offered online and delivered directly to the consumer. The nature of these business models is to generate maximum welfare through the employment of new, innovative and digitalized processes and procedures. This is due to alternative means and location of value creation, alternative organization, supply chains and cost structure. Further, highly digitalized business models are heavily reliant on intangible property (IP) to conduct their activities, i.e. patents, brands or algorithms.

2. What are the competitive distortions you see/experience as a result of the weaknesses in the tax system? What is the impact of these distortions on companies and on Member States? What could be done to eliminate them?

Two forms of competitive distortions emerge:

a) Unfair competition between digital economy and classical economy. For example, the meaning of physical presence (establishment) can be easily availed from by undertakings that offer services online. The proximity to clients and the velocity with which the digitalized economy develops and is capable of implement new technologies to generate profit is significantly different from the classical model. For example, new services on digital platforms can be easily implemented and offered to clients immediately which takes more time for a manufacturer that has to produce goods first make them available to clients afterwards. This issue was partly discussed by the Court of Justice of the EU in the Google Spain case (C-131/12)

b) Unfair competition between multi- and transnational undertakings and SMEs or small undertakings only operating in the market of one Member State. Only companies that operate transnational can benefit from the current gaps in the international tax framework.

The loss of revenue has the biggest impact on Member States since tax is paid outside of the Member State or even the EU.

3. How far have BEPS and recent EU initiatives addressed the tax challenges raised by digitalization?

The proposal for a Common Corporate Tax Base, BEPS initiatives and the OECD action plan have been a starting point for a future reform targeting the digital economy. However, these initiatives only partly target the challenges regarding the taxation of the digital economy.

Tax challenges raised by digitalization are no European phenomenon. The global scale of the digital economy also requires global initiatives either driven by EU initiatives or at collaboration with the EU and other States in the OECD framework.

4. Do you agree that there is a need for a common EU response?

Yes.

However, the digital economy and the taxation thereof is a global phenomenon and can only partly be dealt with at EU level. While an EU measure would clearly ensure profit generated within the EU to be taxed within the EU there remains a risk that this will raise retaliation measures in the US, Japan or BRIC countries. Thus, EU initiatives must be accompanied by global initiatives to address the challenges of taxation of the digital economy, for example through the OECD.

5. Do you agree with the objectives set out above?

In general yes. However, further clarification is needed.

a) Fairness

The proposal that the corporate profits shall be taxed where the value is created is welcomed. Further, fairness also requires that the taxation of undertakings in the digital economy gives due account to issues as the size of companies (large/medium/small/micro companies) and what obligations they are subjected to.
It is emphasized that turnover is a good indicator to identify the size of the company. However, alternative indicators and factors should be considered.

Due account must be taken to not hamper growth and development by taxation that affects start-ups or small digital undertakings disproportional high.

b) Competitiveness

Due account shall be given to a proportional sharing of the burden of taxation. Small undertakings and start-ups shall be given account to since they will struggle to deal with high taxation.

A framework of taxation must ensure fair competition (equal burdens) and not lead to further distortion of competition

c) Integrity of the Single Market

The taxation framework for the digital economy must enhance the effectiveness of the EU taxation framework and not replace the old system by a new tax avoidance scheme.

The new taxation framework must be in coherence with existing EU initiatives and legislation and with the OECD legal frameworks.

A good example for coherence is the Proposal for a Directive on certain aspects concerning contracts for the supply of digital content (COM(2015)634 final) which enhances consumer protection to the supply of digital content. In this context the specific nature of digital content is distinguished from tangible goods or tangible goods that contain digital content. With the new Proposal the Commission sought to close a gap in the existing consumer protection framework which was unclear about its applicability to digital content.

d) Sustainability

Sustainability must be understood as flexibility and openness to new, yet undeveloped business models.

This is required to ensure that the taxation framework for the digital economy does not need revision after two to three years. A long-term solution must aim at being able to adapt to a changing digital economy and new business models that emerge due to more and more digitalization.

Thus, the proposal to introduce short and long term solutions is welcomed. Yet, further refinement is needed to clarify the scope and purpose of short term solutions and to find adequate long-term solutions that make the EU taxation framework fit for the future.

<u>Short-term solutions to tax the digital economy</u>

1. What should be the scope of short-term solutions? Which transactions or companies should be covered?

Regarding the second question see general remarks. In the light of the comments made before, only transactions and companies operating in the virtual and highly digitalized sphere should be covered.

Short term solution must address immediate problems. And, in the light of above immediate problems are either tax aversion through aggressive tax design or new business models availing the classical international tax framework. While the first can also be dealt with by BEPS initiatives, the second problem should be covered by short term solutions.

Further note: The definition of short-term solutions is unclear and must be specified. Are short-term solutions intended as infinite interim measures or are they intended to progressively evolve into long-term solutions?

2. How to design the solution that would minimize potential distortions and compliance costs, for example risk of double taxation?

A key element to minimize potential distortions is to define clear and easily comprehensible definitions and a clear scope of application to which short-term solution applies.

Especially the equalization tax is a new tax. This is the opposite of reduction of bureaucracy! The equalization tax is an appealing short-term solution, yet it raises the risk of double taxation. And what is about the situation, if there is no profit in the country of the equalization tax? You made the example with the creator of an app who is living in Tonga. If he can`t move into profit nevertheless he have to pay the equalization tax without any possibility for charging.

Since the equalization tax is calculated on the basis of the turnover of an undertaking, the equalization tax is paid on top of tax that may be paid in the home or host state. The equalization tax is intended to compensate the State where the profit is gained the tax should be shared between the home and host state of the undertaking. This may require new rules on offsetting and transfer.

Thus, due account must be given to all impacts, positive and negative, of short term solutions.

Also, it would be welcomed that it is clarified to what extent Member States remain to adopt bilateral agreements on the basis of the OECD-MA to avoid double taxation.

3. Do you see additional short term solutions?

No.

However, this might change at a later stage of the development when a clearer scope of the taxation framework for the digital economy evolves.

4. Can you share experiences with unilateral tax measures that were motivated by the challenges of digital economy?

Not at the moment.

<u>Long-term solutions to the taxation of the digital economy</u>

1. How should a business "digital presence" be measured and determined?

The definition of digital presence must give due account to the new business models relied on by the highly digitalized economy. Virtual presence, the location where the profit is generated or the place where the digital content is delivered are possibilities by which digital presence can be measured.

However, the definition of digital presence should be carefully defined weighing all pros and cons of alternative models of digital presence. Also due account should be given if a potential definition of digital presence gives rise to new loopholes for the digital economy.

2. How could meaningful income be attributed to the digital presence?

Financial thresholds can be an option. Only if an undertaking generates a certain profit margin in one Member State digital presence is established.

However, a final and conclusive statement can only be adopted at a later stage of the development of the EU initiative.

3. What companies/transactions should be included within scope?

See General remarks.

Regarding the toolbox spill-over effects of EU tax policies on developing countries no position has been adopted so far. This can be provided at a later stage if needed.