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REQUEST FOR INPUT ON WORK REGARDING THE TAX CHALLENGES OF THE DIGITALISED ECONOMY

A. Digitalisation, Business Models and Value Creation

A.1 The process of digitalisation has become one of the main drivers of innovation and growth across the economy. Please describe the impact of this process on business models, and the nature of these changes (e.g. means and location of value creation, organisation, supply chains and cost structure).

Digitalisation has been a source for undertakings to maximize efficiency and reduce costs, i.e. through the development of fast computer systems or entire production places run by computers and machines. Moreover, digitalization and internet technology led to the development of entire new business models which run without the requirement of physical presence, i.e. online services or information platforms (AirBnB, Google, Facebook, Amazon). A further distinction is needed, however, for undertakings which in part rely on classical industrial characteristics, such as logistics or tangible goods. Amazon and Apple are good examples for this. While Amazon uses an online platform, the products sold via the platform are shipped from storages all over the world using logistics services. Apple on the other hand sells devices (tangible property) that come with special software (intangible property). In this view Apple and Amazon can be considered as hybrid business models which use both, classical industrial characteristics and digital characteristics.

This is in contrast to highly digitalized business models which predominantly rely on virtual or digital environments and lack physical presence or industrial characteristics.

Both business models have been influenced by digitalization significantly. However, the highly digitalized economy is capable of reducing costs, i.e. for supply chains, storage places and logistics or office spaces and employees, since the maintenance of digital services (algorithms, patents, IP) can be carried out by fewer employees or even by digital processes. This maximizes costs and benefits and triggers classical taxation schemes which relied on the principle of establishment.

A.2 Highly digitalised business models are generally heavily reliant on intangible property (IP) to conduct their activities. What role does IP play in highly digitalised businesses, and what are the types of IP that are important for different types of business models (e.g. patents, brands, algorithms, etc.)?

IP is the source of value in highly digitalized economy. For example, online platforms and networks are based on mass of personal data and user information. Personal data and user information are just two examples without which the business model of undertakings such as Google or Facebook would not work or generate value.

A.3 Digitalisation has created new opportunities in the way sales activities can be carried out at a distance from a market and its customers. How are sales operations organised across different highly digitalised business models? What are the relevant business considerations driving remote selling models, and in which circumstances are remote selling models (as opposed to local sales models) most prevalent?

In terms of logistics or sales activities a distinction can be made between hybrid business models and highly digitalized business models.

Hybrid business models still use classical sales activities and logistics and thereby are connected to or located within a market. The example of Amazon and Apple works here as well. For example, although Amazon provides an online platform (distance) the products are predominantly shipped from local storage places.

Highly digitalized business models do not need to be physically present since they contact customers in a purely virtual sphere. Sales operations take place directly with the customer "in its living room". These kind of remote selling is preferred with online platforms, digital services or the supply of digital content. Netflix or Spotify are example of these distance or remote selling business models. The digital content and service is delivered directly to the consumer, i.e. can be streamed at home. For this the EU Commission Proposal for Directive on the supply of Digital Content can be considered (COM(2015) 634 final).

A.4 Digitalisation has permitted businesses to gather and use data across borders to an unprecedented degree. What is the role of data collection and analysis in different highly digitalised business models, and what types of data are being collected and analysed?

Digitalisation led to the development of new technologies and processes being capable of managing large numbers of information and data in real time. With this new services developed

and emerged either for the evaluation of the mass data or for the use of the information and evaluation of this data.

Some business models, such as google or facebook built up their business model upon the evaluation of their user data.

Other business models use the evaluation of mass data to provide better customer support. For example Netflix and Spotify employ algorithms they propose “movies or music you may like” based on the previous selections a customer has made.

A.5 In a number of instances, businesses have developed an architecture around their online platforms that encourages the active participation of users and/or customers from different jurisdictions. Is the establishment and operation of such global (or at least cross-country) user networks new and specific to certain highly digitalised business models, and what are the potential implications for value creation?

No answer possible at this moment.

A.6 The digitalisation of the economy is a process of constant evolution. Please describe how you see business models evolving in the future due to advances in information and communications technology (e.g. Artificial Intelligence, 3D printing).

The development of algorithms and artificial intelligence opens the door towards robotics and automotive driving.

Also medicine and the treatment of patients will see further developments and digital services.

B. Challenges and Opportunities for Tax Systems

B.1 What issues are you experiencing with the current international taxation framework? (e.g. legal, administrative burden, certainty)

A major issue is the different positions and views between the EU, US, Japan and BRIC countries regarding the need and degree to which the digitalized economy must be subjected to taxation. For example, many highly digitalized companies have their seat in the US and pay taxes there although they generate a large portion of revenue in the EU or other States.

Furthermore, the international tax scheme is built upon a “classical” view of an industrial economy where physical presence is the link to the place where a company is taxed. With highly digitalized companies this tax base ceases to exist.

B.2 Digitalisation raises a number of challenges and opportunities for the current international tax system. In particular:

a) What are the implications of highly digitalised business models and their value chain on taxation policy? In particular:

(i) What impact are these business models having on existing tax bases, structures of tax systems and the distribution of taxing rights between countries?

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.

(ii) Are there any specific implications for the taxation of business profits?

See above.

b) What opportunities to improve tax administration services and compliance strategies are created by digital technologies?

Exchange of information and data through digital channels is one mechanism through which tax administration can be improved.

C. Implementation of the BEPS package

C.1 Although still early in the implementation of the BEPS package, how have the various BEPS measures (especially those identified as particularly relevant for the digital economy – i.e. BEPS Actions 3, 6, 7 and 8-10) addressed the BEPS risks and the broader tax challenges raised by digitalisation? Please feel free to support your answers with real life examples illustrating these impacts.

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.

Regarding to BEPS a distinction should be made between the problem of tax aversion, which is in general addressed by the BEPS initiative and the lack of a taxation framework applicable to certain forms of business models in the digital economy, which is the case where the traditional tax base – the principle of establishment – ceases to exist.

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”.

C.2 A growing number of countries have implemented the new guidelines and implementation mechanisms relating to value-added tax (VAT)/ goods and services tax (GST) that were agreed in the BEPS package to level the playing field between domestic and foreign suppliers of intangibles and services. What has been your experience from the implementation of these collection models (e.g. compliance, impact on business operations)? What are some examples of best practice in this area?

No answer possible at this moment.

D. Options to address the broader direct tax policy challenges

D.1 The 2015 Report outlined a number of potential options to address the broader direct tax challenges driven by digitalisation. Please identify and describe the specific challenges associated with the application (e.g. implementation, compliance, neutrality) of these options. What are the advantages and disadvantages of these options, including from an administrative and economic perspective, and how might some of the disadvantages be addressed or mitigated through tax policy design? In particular, comments are welcome on the following specific issues:

a) Tax nexus concept of “significant economic presence”:

(i) What transactions should be included within its scope?

This depends on how digital economy is defined. Does it include hybrid business models and highly digitalized business models or only the highly digitalized business models. A final answer cannot be given at this stage.

(ii) How should the 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.

(iii) How could meaningful income be attributed to the significant economic presence and how would such an approach interact with existing transfer pricing rules and profit attribution rules applicable to the traditional permanent establishment?

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.

(iv) How could such a measure be efficiently and effectively implemented in practice?

No answer possible at this stage.

b) Withholding tax on certain types of digital transactions:

(i) What transactions should be included within its scope?

This depends on how digital economy is defined. Does it include hybrid business models and highly digitalized business models or only the highly digitalized business models. A final answer cannot be given at this stage.

(ii) How could the negative impacts of gross basis taxation be mitigated?

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.

For example, the equalization tax is an appealing short-term solution, yet it raises the risk of double taxation. 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. Since 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.

(iii) How could the threat of double taxation be mitigated?

See above.

(iv) How could such a measure be efficiently and effectively implemented in practice?

See above.

c) Digital equalisation levy:

(i) What transactions should be included within its scope?

No final answer can be given at this stage. However, the initiative should target transactions and activities that operate cross-boarder.

(ii) How could the negative impacts of gross basis taxation be mitigated?

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(iii) How could the threat of double taxation be mitigated?

Equalisation levy must be attached to the national tax scheme in which the levy must be paid. Where the equalization levy is paid on top in one Member State only, the risk of double taxation remains significantly high.

(iv) How could such a measure be efficiently and effectively implemented in practice?

The allocation of supervision and monitoring to a single supervisory authority, which is responsible for the assessment of the consolidated accounts and which determines the equalization levy to be paid in a specific state.

D.2 A number of other tax measures have been proposed, announced or introduced by various countries that seek to address the direct tax challenges of highly digitalised business models (e.g. diverted profit taxes, new withholding taxes, turnover taxes).

a) What are the advantages and disadvantages of these approaches? Where possible, please share any direct experience from the implementation (e.g. compliance, impact on business operations) of these approaches.

Disadvantage: Regulatory competition, double taxation, closing off of the market and fragmentation of taxation rules at a European and global sphere. This leads to higher compliance costs for undertakings which has an even bigger impact for small and medium enterprises.

b) How might some of disadvantages of these approaches be addressed or mitigated through tax policy design?

See answers to D1 above.

c) What are the specific impacts of these unilateral and uncoordinated approaches on the level of certainty and complexity of international taxation?

See answer to point a).

E. Other Comments

E.1 Are there any other issues not mentioned above that you would like to see considered by the TFDE as part of its work on taxation and digitalisation?

Two issues that emerge is the personal scope, i.e. what entities and undertakings are bound. Will there be a categorization of undertakings for which the framework is mandatory? (similar to the current EU proposal on the CCTB)

Growth is important for a stable economy. Since the digitalization has been a valuable factor for innovation and development, the taxation of the digital economy should not eradicate or render meaningless the advantages of the digitalisation.