AmCham EU
SPEAKING FOR AMERICAN BUSINESS IN EUROPE

Our position

AmCham EU's position on Digital Tax

AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Aggregate US investment in Europe totalled more than €2 trillion in 2017, directly supports more than 4.7 million jobs in Europe, and generates billions of euros annually in income, trade and research and development.

1. Executive Summary

The American Chamber of Commerce to the European Union (AmCham EU) understands the public interest and political interest in ensuring that multinational groups pay taxes in the countries where they operate, and supports the overarching principle of ensuring that tax should be levied where value is created. Digitalisation poses challenges to the international tax system and a detailed and global investigation and discussion on whether new value creation factors exist in certain circumstances is appropriate. All businesses are digitalising (and using digital services) and any solutions will therefore impact all businesses and consumers.

The EU is the third largest trading bloc by population, the second largest world economy, and one of the key leaders in a global discussion regarding tax bases in the digital age. We therefore welcome the Commission's work as an important contribution to what must be a multilateral debate that does actively seeks to encourage and build the opportunities for growth that digitalisation can offer.

However, we are concerned that the EU is considering departing from existing agreed international principles at a time when there is commitment from 113 countries to examine solutions together. A departure from internationally agreed principles would make investment in the EU and provision of services to EU citizens / businesses more costly. We therefore endorse the continuation of discussions at the Organisation for Economic Co-operation and Development (OECD) rather than unilateral measures.

Notwithstanding this, as well as outlining several specific concerns, our detailed position paper seeks to assess the Commission's proposals against globally agreed standards (such as the design considerations for interim measures as agreed by countries favouring them[1], and the OECD's Ottawa Principles) and make positive recommendations with the aim of ensuring that EU's discussion (and any unilateral measures that it ultimately introduces) meet its objectives.

Recommendations for Comprehensive Solution

In line with the OECD's Ottawa principles, the proposals should seek to:

- *Ensure thresholds are practical and appropriate to ensure compliance and non-discrimination*
- *Include detailed guidance on profit attribution between states based on all forms of value creation based on principles that are measurable and neutral*
- *Apply equally to all businesses of all industries undertaking such activities*

Recommendations for Interim Solution

In line with the design considerations set out by countries favouring interim measures in the OECD's 2018 interim report, the proposals should seek to:

- *Target abusive arrangements only*
- *Ensure comprehensive double taxation relief and dispute resolution mechanisms are in place*
- *Include sunset clauses*
- *Ensure thresholds are practical and appropriate to ensure compliance and non-discrimination.*

Key Concerns regarding unilateral EU Action

- Turnover taxes are damaging to economic growth because they do not take profitability into account
- Unilateral action may damage international relations, invite responses from other countries (that may seek to move non-digital services towards a destination base), and harm the opportunity for a global solution
- Unilateral "interim" measures can harm the opportunities for global agreement and without sunset clauses may not be "interim" (and could rather be expanded)
- The transition towards a long-term solution could place restrictions on Member States' sovereign rights to negotiate treaties freely
- Tax shifts from countries of establishment to countries of destination could adversely impact EU countries and companies that have invested in education and R&D, thus working against the EU's broader digital strategy
- Taxes based on user numbers will disadvantage smaller Member States in negotiations

[1] Chapter 6 of the OECD 2018 Interim Report on Tax Challenges Arising from Digitalisation notes that *"Countries in favour of the introduction of interim measures have set out guidance on the design considerations that need to be taken into account when considering the introduction of such measures."*

We hope that this is the start of a constructive dialogue on the future of the international tax framework and look forward to working with the European Commission, Member States, and other stakeholders as this project progresses, in whatever ways may be helpful.

2. Introduction

AmCham EU understands the public interest and political interest in ensuring that multinational groups pay taxes in the countries where they operate in order to support the infrastructure and legal protections that they benefit from and also to contribute to general taxation to support government's spending priorities.

AmCham EU supports the overarching principle of ensuring that tax should be levied where value is created. This is in line with the objectives of the OECD Base Erosion and Profit Shifting (BEPS) Project (and much of the EU's implementation thereof), and is consistent with the objectives of the European Commission and the European Union Member States that have expressed support for new tax measures. However, it must be recognised that it is not generally agreed exactly how value creation should be determined in the context of digitalisation, and much more work needs to be done to understand this.

AmCham EU also recognises that digitalisation poses challenges to the existing international tax system, as well as to tax bases. We agree that ways in which data are used, and the impact of greater user participation and engagement in business models require a detailed investigation and discussion on whether these and other new value creation factors exist in certain circumstances. However, evidence shows[2] that "digital" businesses do not pay the significantly lower tax rates that the European Commission's report indicates[3]. Additionally, the impact of the recent US Tax Reform package (which was enacted 2017) is not reflected in these statistics, and it may address some of the Commission's concerns in this area because it effectively applies a minimum tax on worldwide earnings of US headed multinationals.

Accordingly, we believe that the real issues relate more to the allocation of tax base between countries than to the overall contributions of different global multinational enterprises (MNEs). A digital revolution is underway and will continue to impact all sectors of the economy. We strongly agree with the OECD's BEPS Action 1 Report ("the Action 1 Report"[4]) that the digital economy cannot be ring-fenced. The Commission's Digital Strategy[5] is clear that digitalisation can deliver smart, sustainable and inclusive growth across Europe. Access to Information and Communication Technology (ICT) by small and medium businesses is recognised as critical for inclusive growth[6], and we are concerned that the proposals could negatively impact these objectives.

Tax bases will continue to evolve (and change between countries) as digitalisation continues to enhance our lives and economies. We therefore agree with the Commission that a multilateral discussion is needed. We welcome the Commission's work as an important contribution to what must be a multilateral debate that does not adversely impact the opportunities for growth for all that digitalisation can offer.

The OECD Action 1 Report identified data, nexus, and income characterisation as broader challenges, the impact of which on tax bases should be monitored in 2020. This timetable has already been accelerated, and is now running alongside the monitoring of the impact of the BEPS recommendations. The OECD's report *Tax Challenges Arising from Digitalisation – Interim Report 2018* ("the 2018 OECD report"[7]) identifies salient features of "digital" business models that need to be examined and discussed in detail, multilaterally, and with a range of stakeholders by the OECD's Inclusive Framework of 113 countries. We support this work, and the involvement of the European Commission and EU Member States in it.

[2] http://ecipe.org/publications/digital-companies-and-their-fair-share-of-taxes/

[3] We note that the author of the report cited in the Commission's Digital Tax Package has suggested that his findings have been misinterpreted by the Commission: https://www.law360.com/articles/1019073/eu-study-s-author-doubts-digital-transactions-undertaxed

[4] http://www.oecd.org/ctp/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report-9789264241046-en.htm

[5] https://ec.europa.eu/digital-single-market/en/europe-2020-strategy

[6] https://ec.europa.eu/growth/industry/policy/digital-transformation_en

[7]

In this position paper we have sought to contribute in three areas:

i) The European Commission's Digital Tax Package as a whole; paying particular attention to the interaction of its various elements,

ii) The European Commission's proposal for a Council Directive laying down rules relating to the corporate taxation of a Significant Digital Presence ("the Comprehensive Solution"), and

iii) The European Commission's proposal for a Council Directive on the common system of a Digital Services Tax on revenues resulting from the provision of certain digital services ("the Interim Solution")

In each of these areas, we have sought to be constructive with our contributions, although we have detailed some significant concerns we have with elements of the proposals. We hope that this is the start of a constructive dialogue on the future of the international tax framework and look forward to working with the European Commission, Member States, and other stakeholders as this project progresses, in whatever ways may be helpful.

3. The European Commission's Digital Tax Package as a whole

3.1 Interim Solution

We believe that introduction of interim measures outside of the current international norms embodied in the OECD and UN Model Tax Conventions (i.e., taxation of business profits, with mechanism for relief of double taxation thereof) is unnecessary at a stage when the OECD and G20 (leading a group of 113 countries) have committed to seek an international consensus within two years. Adding additional pressure in this discussion may be counterproductive in those circumstances. Introduction of the DST will reduce the incentives for governments to seek a global consensus, and in practice may not be short term (in fact, it would be easier for Member States to expand the scope unilaterally than to repeal the implementing EU Directive that mandates a minimum level/scope of the tax).As a representative of US investors into the EU, we are concerned at the impact such measures could have on transatlantic tax relationships at a time when there is already heightened tension in that relationship.

Turnover taxes are damaging to economic growth for many reasons, including because they do not distinguish between different levels of profitability that different businesses have at different stages of their lifecycles.

While we understand that the Interim Solution has been described by some as "symbolic" on the basis that it demonstrates (publicly and to trading partners) the seriousness with which the EU wishes to address the issues, we are concerned that it could instead be construed as "symbolic" of a belief in countries' rights to introduce unilateral, unconventional, non-profits based measures outside of the international taxation framework rather than constructively engaging in a sustained and purposeful negotiation. This would not be a good message for the EU's trading partners to receive, and may trigger retaliatory action, which may also move the direction of global reform away from the Commission's objectives. Such actions may also encourage other countries to depart from the process of bilateral and multilateral negotiation of aligned systems and methodologies that eliminate double taxation and increase trade, investment and growth.

If the EU chooses to introduce interim measures, we believe that the potential damage would be lessened if these measures are demonstrably (and specifically demonstrated to be) aligned with the design considerations outlined (by countries favouring such measures) in the 2018 OECD report. In an effort to be collaborative in this regard, later in this position paper we have assessed the short term measures against these design recommendations to demonstrate areas that we believe the EU must resolve at a minimum.

Finally, we would like to express a concern regarding the practical implications of using the new concept of "users" to allocate taxing rights. We observe that the largest five Member States (by population) account for over 70% of the entire EU population. We would expect residents/citizens to be a reasonable proxy for "users" (although it may be the case that there are more active users per citizen in some Member States than others). All five of these Member States (Germany, France, UK, Italy, and Spain) have publicly called on the Commission

to develop turnover based proposals. Conversely, the smallest five Member States by population account for less than 1% of the EU population. If there is no agreement in the European Council to introduce these measures across the whole of the EU, and larger Member States by population introduce similar measures unilaterally that are inspired by the Commission's proposals, this would have a significant impact on other countries (including the Member States who had not wanted to introduce such a measure across the EU). We are concerned at the impact that this could have on not just the EU but also the broader global negotiations – and the double taxation that would inevitably result.

It should also be considered the impact that changes to such fundamental principles of taxation (from country of establishment to countries of destination) could have on the European businesses that have made significant investments in education, as well as research and development (R&D) incentives to encourage start-ups, who would be disadvantaged when their companies bring home profits made internationally. The Interim Solution would essentially reward digital consumption over digital creation. Given the EU's broader digital objectives, the EU should consider the impact on its objectives to promote and reward companies for their digital investments, innovation, and ability to create successful companies generally.

3.2 Interaction of Interim and Comprehensive Solutions

AmCham EU supports the OECD Ottawa principles, as amended by the OECD BEPS Project Action 1 Final Report[8]. Long term or interim changes to (and departures from) the international tax framework should still follow the Ottawa principles. It is clear that the proposed Interim Solution does not follow the Ottawa principles; we understand that some countries may see justification in such a departure to the extent that the measures are temporary and targeted at genuine abuse (rather than, simply, new business models or complicated tax allocation questions absent widespread international agreement).

However, the Interim Solution is not explicitly designed to be time-limited, nor is it targeted at abuse. Rather it includes broad measures that – in their interaction with the Comprehensive Solution – appear to disproportionately penalise a focused group of companies resident in non-EU countries. These non-EU countries have not agreed (and, quite frankly, are unlikely to agree) to new methods of allocating profits in tax treaties that are aligned with the proposed Comprehensive Solution. Negotiation of tax treaties can take many years, and by definition requires countries to reach common agreement on an allocation of taxing rights for each that is less than either would seek to assert in the absence of the agreement. In this regard, the Interim Solution carries a risk of evolving into a long term solution.

The alternative is that the Interim Solution is replaced with the Commission's proposed Comprehensive Solution, which would need to be enshrined in treaties. We do not believe that this is an appropriate or desirable negotiating position in which to place EU Member States and fear that it could harm their ability to agree double tax treaties (both with regard to substance and perception of good faith). Additionally, the possibility that the Interim Solution is removed for countries who have renegotiated their treaties with EU Member States but not with non-EU countries (and the expectation that EU Member States would seek to agree a mechanism to amend their bilateral treaties with other EU Member States first) poses a range of problems that need further investigation, including permissibility under WTO rules, interaction with existing non-discrimination clauses, the capacity of countries to agree new networks of bilateral tax treaties, and whether prioritisation of certain treaties could be deemed discriminatory.

We therefore believe that it would be more appropriate for an interim measure to have a specific sunset clause than the proposed mechanism of interaction with (yet to be negotiated) bilateral tax treaties.

[8] Neutrality, Efficiency, Certainty & Simplicity, Effectiveness & fairness, and Flexibility & sustainability

3.3 Comprehensive Solution

We welcome the work that the European Commission has undertaken in seeking to explain its concerns and to contribute to the multilateral conversation by putting forward specific proposals. However, we are concerned that the EU is considering departing from existing agreed international principles ahead of a global agreement – especially when there is commitment from the 113 countries of the OECD Inclusive Framework to examine the concerns and potential solutions together.

A departure from internationally agreed principles of nexus and profit attribution would make investment in the EU, and provision of services to EU citizens and businesses more costly both with regards to compliance and double taxation. We therefore endorse the continuation of discussions at the OECD as the primary forum for European Member States to discuss proposed changes.

As noted above, AmCham EU supports the OECD Ottawa principles, as amended by the OECD BEPS Project Action 1 Final Report. Long term changes to (and departures from) the international tax framework should ensure that they follow the Ottawa principles. Again, in an effort to be constructive, we have sought to measure the Comprehensive Solution against these principles below.

4. The Comprehensive Solution

4.1 General Comments

It is not agreed by businesses whether “users” or “data” can contribute significant value. Even for businesses that believe that their users do have a value to them, each user may have a different value, and importantly a recognition of value is not the same as a realisation of income. The realisation of income requires analysis and insights from user data, alongside the business strategies, governance and ecosystems that attract and retain users. The approach outlined in the recent position paper from the UK Treasury[9] provides a more granular analysis of different digital business models and the role of user participation in them. While we have concerns about the broad applicability of this new theory, we do believe that the question of value creation needs to be approached in this level of detail, and with the UK’s level of engagement.

The introduction of a significant digital presence (“SDP”) threshold would untether the long-established PE concept from physical presence and thus be a significant departure from the existing rules. Current profit attribution rules look to the value generated by significant people functions (“SPFs”) within a country. It is unlikely that there could be material SPFs in a country (under the current framework) without the existing PE thresholds also being triggered. Clearly therefore, a revised SDP threshold would not allocate significantly more profits to any country than are already allocated, unless attribution rules are also amended. The Commission is therefore correct to seek to agree principles for profit attribution simultaneously with any revision to the threshold, and we believe that neither profit attribution rules nor revised thresholds should be introduced without the other. The revisions to Article 5 of the OECD’s Model Tax Convention under the BEPS Project were finalised before the profit attribution guidelines were updated, and this caused significant uncertainty for business. The lack of agreement of a uniform approach regarding attribution from the OECD’s latest profit attribution guidelines continues to concern businesses, and uncertainty over taxation rights and double taxation relief remain.

Further, if the EU adopts a threshold and attribution rules that differ from international norms, double or multiple taxation will be more likely to occur even where the non-EU countries in which the MNE operates agree to revised profit attribution rules, because the PE rules of still other countries where the MNE operates may seek to attribute the same profits under more traditional transfer pricing methods.

[9] Corporate Tax and the Digital Economy (esp. Chart 2A page 11): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/689240/corporate_tax_and_the_digital_economy_update_web.pdf

With regards to data, there are third party comparables available for some types of data at some stages of the data collection and analysis life cycle, and while these are challenging to apply to specific data sets, this may give a more appropriate (and easier to determine) result than the profit split method. We agree with the OECD that the material value from data is generated at later stages of the cycle through detailed analysis, application of algorithms, compilation and decision making (for which comparables will be harder to find) and therefore we think it logical that it would be more appropriate in most cases to consider the country of the user as the tested party to receive an arm's length remuneration, rather than embarking on a complicated multi-party profit split calculation (unless the country of the user is also performing these other value generating activities).

Moreover, the concept of valuing data or users' contributions as part of a profit splitting calculation is difficult to reconcile with existing transfer pricing principles (where individual transactions are priced based on their facts and circumstances), and we do not believe that it is appropriate to consider factors of collection, sale, and service provision alongside these existing principles under a profit split method. However, if the EU decides to introduce such principles, then significantly more detail is required. As well as profit split factors regarding interaction with EU users, other relevant functions, assets and risks in the value creation process should be considered (with regard to (i) "traditional" activities, (ii) non-traditional methods of value creation that are not related to the user base, and (iii) the value that the counterparty may apply with respect to its users in non-EU countries). A non-exhaustive list of factors for consideration may include:

- Investment costs (including historic investment costs) incurred developing the platform generally (as opposed to specific investment on localisation for the EU country in question);
- Research and Development activities;
- Data consolidation and processing activities;
- Location of management decisions regarding the development, enhancement, maintenance, protection and exploitation of the platform;
- Return on capital, risk, and financing costs; and
- The value contributed by users in other (non-EU) countries.

Finally, as a practical matter, we are concerned that the threshold is set so low (with regards to users and contracts concluded in particular) that it may undermine the existing PE thresholds.

4.2 Assessment against the Ottawa Principles

Neutrality: The proposals are not aligned with the neutrality concept because they do not apply equally to all businesses (due to a range of exemptions as listed in Annex III).

Efficiency: The proposals would impose a significant further compliance burden on businesses because they depart from the internationally agreed thresholds and profit attribution methods. This could be particularly challenging if the OECD work agrees an alternative methodology in its upcoming recommendations in 2019/2020 (because either the EU would need to update to a new internationally agreed standard, or differences would remain). The cost and complexity of designing and implementing systems to track new types of PE will be significant, which is one of the reasons businesses favour uniform rules. Clearly having two or three such systems in a short space of time will increase costs.

Certainty and simplicity: Systems may not currently identify where the proposed threshold is crossed (and implementing new systems that do will not be simple). However, while we have concerns about the thresholds themselves (see below) and the potential privacy concerns that would need to be addressed for businesses to be able to determine if they are crossed (e.g. collection on IP addresses), we believe that the threshold factors put forward are relatively clear). We are more concerned about certainty with regards to profits to be attributed, based on the limited guidance provided. We would also note that renegotiating treaties with every EU country in line with the recommendations, and with every non-EU country potentially along other negotiated lines

(which may or may not be sufficient to disapply the Interim Solution) will be a complicated endeavour for Member States and will result in considerable uncertainty while it is undertaken.

Effectiveness and fairness: The proposals would clearly be effective in ensuring that a significant number more businesses, both digital and non-digital, would have PEs in EU Member States than under the current rules. They may be less effective in generating additional tax for EU Member States, firstly because they would require treaty changes (which in themselves require negotiation) in order to be effective, and secondly because the current proposed profit attribution rules are lacking in detail and we are not sure how they would be interpreted by tax administrations and the courts. The OECD notes that enforceability is a key component of fairness. In reality, it may be difficult for tax administrations to fairly enforce the low thresholds and it could be difficult from a practical and legal perspective to compel groups without a physical presence to file returns and pay taxes (which is not equitable treatment for those groups who rightly take such obligations seriously).

Flexibility and sustainability: It is challenging to say with certainty whether a new threshold will be more resilient to changes in business models than the existing thresholds, but given the inherent uncertainty regarding future developments in business as a result of the digitalisation of the economy (a revolution that we are in the middle of, rather than at the end of), this seems very unlikely. In fact, it is possible that as traditional and digital business converge (a phenomenon that is currently well underway), the level of uncertainty will only increase across all business models and this may have the consequence of slowing innovation and growth within this important business sector.

4.3 Technical concerns

In reviewing the Comprehensive Solution, we have identified a number of technical concerns and questions that we believe need to be addressed:

- As well as being very low, we do not believe that the thresholds are consistent in their identification of significant presences. For example, 3,000 business contracts for $100 each is a much lower threshold than the revenue threshold of €7m.
- We do not believe that a profit split method should be the default method (and even if it is, it should remain consistent with international principles – the OECD Guidance in this area is expected later in 2018). A fundamental principle of transfer pricing for OECD is that the most appropriate method is always chosen with regards to the facts and circumstances – not rebuttable presumptions.
- We believe that much more guidance is required on the proposed revised profit split method. While calculating average global revenues or profits per user sounds like a very straightforward calculation, it is a detailed yet very blunt assessment tool reflecting no difference in profits that different users may provide. For example, other factors that may be relevant and which may significantly alter country allocations include wealth, location, level of activity, privacy settings, age, occupation, etc. (although it would not be possible to calculate this on a user by user basis).
- We believe that the current list of digital activities is too broad in scope. Many of the activities could be interpreted as “routine” business transactions that are common among large multinational groups. Unless the scope of the Comprehensive Solution is narrowed significantly, there may be significant unintended consequences to all types of businesses.

5. The Interim Solution

5.1 General Comments

We do not believe that turnover is an appropriate tax base to assess profits, and believe that the proposed Digital Services Tax (“DST”) could cause significant economic damage. The proposals target the turnover of certain digital activities without a link to either profits or the value creation in the jurisdiction where they are

levied. This should not be described as a corporate tax as it has no correlation to net income / profits. The DST is highly targeted at a very small group of companies and it should be considered whether this is in line with EU and WTO non-discrimination rules. It should also be confirmed that such a tax would be in line with the EU's Treaties and Directives on Sales Taxes (e.g. VAT).

Similarly, as it has no correlation with the scope of activities that would be taxable under the proposed Comprehensive Solution, the levels of tax that in-scope businesses would pay under the Interim and Comprehensive Solutions would differ significantly. Therefore the Interim Solution cannot be described as a step towards the Comprehensive Solution. The example below illustrates how the proposals may not be a good proxy for the tax due under proposed Comprehensive Solution, nor may they produce consistent results.

Table 1: Example

Assumptions:

- Company A is tax resident outside the EU in Country XYZ. It provides users with a multi-sided platform to sell second hand cars to each other.
- Company A has a significant number of users in the US and UK, but none in any other EU country. It crosses the €750m global and €50m EU taxable revenues threshold.
- Company A takes a commission of 1% of each transaction that its users undertake, and generates a global net margin before tax of 40%. When a functional analysis is performed under the proposed profit split method outlined in the Comprehensive Solution, one half of this (20%) is allocated to the territory of the user.
- Company A is seeking to expand into France and Germany.
- France has signed a revised treaty with the XYZ based on the Commission's proposed Comprehensive Solution. Germany has no treaty with XYZ.
- XYZ's local tax system exempts profits and losses generated in overseas treaty partner jurisdictions (with traditional profit allocation concepts), but has agreed to exempt profits of Significant Digital Presence ("SDP") PEs based on the profit split method proposed by the Commission.
- Following impressive year 1 market penetration, investment in each local market is increased for year 2.
- XYZ does not allow credit or deduction for DST paid.

Year 1

	France	Germany
Revenue (€)	4,000,000	2,500,000
Users	75,000	50,000
Contracts Concluded	2,000	1,600
Threshold crossed?	No	N/A
Revenue	4,000,000	2,500,000
Costs to service local market (advertising, platform localisation, language, etc)	(6,000,000)	(6,000,000)
Investment marginal profit/(loss) before tax and DST	(2,000,000)	(3,500,000)

XYZ taxes / (credit) at 24%	(480,000)	(840,000)
SDP tax (French tax rate 28% * profit split margin 10%)	N/A	N/A
DST charge at 3% (€)[10]	N/A	75,000
Global ETR on investment marginal profits	24.0%	21.9%
EU ETR on investment marginal profits	0.0%	-2.14%

Year 2

	France	**Germany**
Revenue (€)	8,000,000	8,000,000
Users	100,000	100,000
Contracts Concluded	4,000	4,000
Threshold crossed?	Yes	N/A
Revenue	8,000,000	8,000,000
Costs to service local market (advertising, platform localisation, language, etc)	(6,000,000)	(6,000,000)
Investment marginal profit/(loss) before tax and DST	2,000,000	2,000,000
XYZ taxes / (credit) at 24%	N/A	480,000
SDP tax (French rate 28% * profit split margin 20%)	448,000	N/A
DST charge at 3% (€)	N/A	240,000
Global ETR on investment marginal profits	22.4%	36.0%
EU ETR on investment marginal profits	22.4%	12.0%

Conclusions:

- In year 1, despite France having higher sales than Germany, it does not receive any tax because the SDP threshold is not crossed. Because losses are made in both Germany and France, credits are available in XYZ. This would discourage Germany from signing a treaty with XYZ, and discourage Company A from investing in Germany.
- Conversely, in year 2, despite the same "presence" in France and Germany (sales, users, contracts), the tax rates suffered are vastly different under the DST to the SDP.
- The results would be different if the business had a much lower margin (or a much lower margin attributable to the users under the profit split method). If the global profit margin were only 10% (of which only 5% were attributable to France) then again DST would raise significantly more in year 2.

[10] It is assumed that DST would only be deductible against CIT in the Member State where the users are based that it relates to (and thus if there is no taxable presence or insufficient taxable profits in any Member States to offset, the benefit would be lost). However, the proposals are unclear on how this mechanism would work in practice.

The above example is particularly concerning when the varying levels of profitability of the targeted businesses is concerned. Many businesses make very low profits (or even losses) relative to their turnovers in early years of investments. Turnover based taxes would leave even less available to invest back into the business. Many businesses (even when out of their growth phases) generate low net margins (in some cases lower than 3%), and accordingly would either need to increase prices to EU customers or not provide services to EU users at all to avoid making losses. The costs would therefore fall on EU consumers and businesses who in many cases rely on the "Digital Services" that are provided by large digital businesses for their own growth. Even for those with higher margins, when considering investments in or outside of the EU, a 3% levy would place the EU at a considerable disadvantage in attracting investment.

5.2 Assessment against design considerations referred to in 2018 OECD Report[11]

The 2018 OECD report refers to a number of design considerations that should be adhered to by any interim measures introduced. These design considerations are said to have been agreed by the countries that favoured interim measures (rather than recommended by the OECD). We have commented on the DST for each.

- Impact on investment, innovation, and growth (and impact on welfare)
  - Common tax thresholds and methods of profit attribution have driven increases in investment, innovation, growth, jobs and welfare.
  - It is hard to see how a departure from the international norms would not have a negative impact on investment into the EU and the provision (and cost) of services to EU businesses and citizens.
  - However, we believe that this negative impact could be lessened by appropriately targeting the proposals at abusive arrangements. Businesses generally favour credit mechanisms over deduction mechanisms where they are available, because they more comprehensively limit the negative impact of double taxation.
- Potential economic incidence of taxation on consumers and business
  - Even if simultaneously implemented with the Comprehensive Solution, there would clearly be a change in the allocation of taxing rights between EU Member States, because the location of value generating activities (and corresponding corporate tax base under the existing system) is not aligned with revenues.
  - If the Comprehensive Solution was not implemented simultaneously, this would result in the highest increase in tax on services provided to EU citizens and businesses (by any company, whether in or outside of the EU). The deduction mechanism would not be sufficient to offset these costs even if it were amended to ensure that 100% of DST is deductible (as it appears currently that sufficient taxable profits in each Member State would be required for the tax to be deducted against), and would likely be passed on to consumers in whole or in part. Additionally, a credit (unlike a deduction) would allow for elimination of double taxation in some (but not all) cases so it is preferred.
  - If the Comprehensive Solution was implemented across the EU simultaneously, this would result in a significant change of tax base allocation within the EU, and could be construed as discriminatory because DST would then impact only non-EU companies. Additionally, it would still result in a higher overall levels of tax than is currently paid (increasing the costs on consumers and EU businesses for in scope "Digital Services") because there is no credit mechanism to eliminate double taxation.
- Possible over-taxation
  - Without effective credit mechanisms in place, there will be businesses already paying taxes (either within or outside of the EU) who would be subject to double taxation (paying both traditional corporate tax and DST).

[11] Chapter 6 of the OECD 2018 Interim Report on Tax Challenges Arising from Digitalisation notes that *"Countries in favour of the introduction of interim measures have set out guidance on the design considerations that need to be taken into account when considering the introduction of such measures."*

  - To the extent that such businesses are paying low overall effective tax rates, this is unlikely to be considered over-taxation. However, the evidence shows that "digital" businesses do not pay materially lower tax rates than other businesses. Even if there were some businesses who were paying significantly lower levels of tax than the EU considers to be a "fair" rate of tax, the DST is not targeted enough to identify such companies. Accordingly the taxpayers who are already paying high rates of tax may be hit hardest by the DST.
  - We do not believe that a "deduction" mechanism is sufficient to relieve this issue. Deductions are worth only a fraction of credits (except for loss making businesses) in economic terms. Additionally, it is unclear how the deduction mechanism would work in practice (see below).
  - Many businesses currently generate a lower margin than 3%. To the extent that DST pushes such businesses from low profits into a loss making position, we believe this is clear evidence that such businesses would suffer from over-taxation.
- Possible difficulties in implementing as only interim measures
  - As noted above, we are concerned that the measures would not currently qualify as "interim" because they would presumably be required until every EU Member State has signed updated treaties with every other country in the world. We do not believe this is a realistic objective given the time commitment of negotiating such treaties and the potential resistance of other countries from moving away from the global consensus.
  - We would therefore urge sunset clauses to be included. In their absence, at the very least, a rolling review period of one or two years after which the Commission could analyse the impact and Member States would have to positively vote to keep the measures in force.
  - As noted above, we are also concerned that the "interim" measures could be easily modified to include additional perceived abusive business models or transactions. Any modification or expansion would further exacerbate our concerns with the current design of the DST.
- Compliance and administration costs
  - The compliance and administration costs of the tax would be significant; many businesses do not track the metrics that would be required to calculate the taxes payable (e.g. user location). Moreover, it is possible that businesses may not track these metrics in consistent ways, which could lead to a distortion of the tax payable.
  - Additionally, businesses with over €750m in global revenues would need to carry out significant calculations (and invest in systems to gather the required information) even if they were ultimately not subject to the tax. A different threshold for determining a significant EU presence that is based on available accounting information would therefore be preferred.
  - We endorse the proposals for businesses to be able to pay the taxes due to one Member State, for distribution among the other 27 Member States.

5.3 Technical concerns

In reviewing the Interim Solution, we have identified a number of technical concerns and questions that we believe need to be addressed before such proposals become final:

- The "transmission" of data (rather than, for example, the sale of data) is a very low threshold. While intra-group revenues are excluded from the general scope, the external revenues that arise subsequent to (and as a result of) an intra-group data transfer could be taxed. Furthermore, those revenues may not be in scope if the data were used to generate revenues without such transmission.
- For the purposes of calculating DST, the location of users must be known. IP addresses will generally be available, but can be obscured by users. Other methods of geolocation (including future methods which have not yet been conceived) will therefore be more accurate than IP addresses (unless deliberately falsified by users). However, they are much less frequently available to service providers. The wording that other

methods should always be used "if more accurate" therefore places an unnecessary burden on taxpayers that it will simply not be possible to comply with in many cases.

- For the purposes of calculating advertising revenue, an advertisement being shown is generally not a good proxy for the revenues generated from that user. Many businesses collect advertising revenues only when an advert is actually clicked on by a user.
- The dates for payment of DST may be sooner (or later) than the corporate tax deadlines in any Member State. Even to the extent that the tax is deductible, this may cause cash-flow concerns. Additionally, even if it were possible to identify the total amount of DST payable in the deadlines suggested, the corporation tax due in each Member State may not be known at that time.
- While it is included in the preamble that DST should be deductible against corporate taxes, there does not appear to be a comprehensive mechanism included in the draft directive text to ensure this is the case. It remains unclear therefore how this would work in practice. If the DST can only be offset against corporate tax in the Member State of the user that is deemed to derive the DST[12], this would result in higher tax burdens in countries where companies have users without taxable presence. This does not appear to be in line with the aims of the single market.
- The exclusion of certain activities (supply of digital content, communication or payment services) only where provision of that service is the sole or main purpose of the interface could discourage businesses from developing such services in-house (instead relying on third party providers who provide solely or mainly those services). This will have a negative impact on competition, innovation and user experiences, and we recommend that it be broadened accordingly.
- We welcome the exclusion for financial services provided through multi sided digital interfaces (please see explanation of Article 3 on page 9 of the draft directive) we have concerns that the wording of Article 3 itself does not sufficiently and appropriately reflect this objective.
- There may be concerns around privacy laws for businesses in the collection of user information in order to comply with the proposals. We recommend that the interaction with the EU General Data Protection Regulations (GDPR) rules is further examined, and that any final Directive(s) have explicit statement(s) that any data required by Member States to be collected must consistent with the GDPR in light of its recent introduction.

[12] This element of the proposal is not included in the draft directive text, and it is unclear in the preamble whether the deduction is intended to be against corporation tax in the country of the user or of the entity making the payment.