

Comments on EU Directive Proposals regarding 'Fair Taxation of the Digital Economy'

Brussels, 18 June 2018

Introduction

DIGITALEUROPE and its members are grateful for the opportunity to comment on the EU directive proposals on digital services tax and significant digital presence, released on 21 March 2018.

DIGITALEUROPE represents the digital technology industry in Europe. Our members include 60 world-leading corporations in IT, telecoms and consumer electronics companies, on one hand, and 38 national trade associations whose membership gives us access to more than 36,000 businesses across Europe, mostly SMEs and start-ups.

DIGITALEUROPE wants a European Union that nurtures and supports digital technology industries, and that prospers from the jobs we provide, the innovation and economic benefits we deliver and the societal challenges we address.

Key Messages

- **The digital economy should not and cannot be ring-fenced.** Separate sets of rules will not promote the goals such as fairer, more effective and efficient taxation, tax certainty and better functioning of the (Digital) Single Market or even prevent tax avoidance.
- The EU aims for an international solution to update the taxation rules to be fit for the 21st century, as confirmed on 11 June by the G7 communiqué: "We are committed to work together to seek a consensus-based solution by 2020. We will exchange approaches and support international efforts to deliver fair, progressive, effective and efficient tax systems. We welcome the OECD interim report analysing the impact of digitalization of the economy on the international tax system." Likewise, DIGITALEUROPE **fully supports OECD-led efforts** to review the appropriateness of the current international tax framework, and whether value creation from data should be recognized in allocation of taxing rights and receipts, and to achieve global consensus and alignment of rules.
- To safeguard the principles of fairness and integrity in tax policy, any tax on the activities of corporations **should be linked to profit**, not revenues, and **should not result in double taxation** and not undermine the existing tax treaties.

1. Digital Services Tax

The directive proposal introduces a digital services tax (hereafter: 'DST') of 3 % on the revenues resulting from the provision of certain digital services. These digital services would include:

1. The placing on a digital interface of advertising targeted at users of that interface;
2. The making available to users of a multi-sided digital interface which allows users to find other users and to interact with them, and which may also facilitate the provision of underlying supplies of goods or services directly between users;
3. The transmission of data collected about users and generated from users' activities on digital interfaces.

1.1. Principle Arguments

DIGITALEUROPE acknowledges that the international corporate tax framework needs some updating to be fit for the 21st century, as the current tax legislation is built on traditional business models and does not take into account the effect of digitalization. If changes to taxation due to the ongoing digitalization of economy is planned, an international approach is urged. A consistent solution would be less harmful than Member States' own internal initiatives to tax digital services. However, for the below listed reasons, we believe the DST interim measure is not an advisable option and likely to cause interpretation problems, costly tax disputes, double taxation, cutting the companies' investment money having a negative impact to the competitiveness and functioning of the EU as a Digital Single Market. Incompatibilities in global taxation systems might even cause risk of new taxation loop holes and tax avoidance. Thus, radically different taxation rules might have the opposite effect than was the goal sought.

- The tax challenges of the increasingly digitalized world should be addressed at a global level through the OECD. International consensus is needed to achieve an international tax framework fit for the 21st century that nurtures technology and innovation, supports the skills and jobs it requires and maximises the growth potential of the digital single market.
- An overriding concern is that the DST proposal targets revenues, rather than profits, arising from certain digital activities. Doing so would not only go against longstanding international principles on corporate taxation, it would also disproportionately target low-margin and high-investment business models.
- We are concerned that the EU proposals are not based on a **sound and thorough economic impact analysis**. The analysis was done including both DST and the digital permanent establishment proposals. Thus, it might not be arguable to use the impact analysis to justify the proposals separately. A thorough economic impact analysis should take into account changes in corporate taxation due to BEPS, ATAD, US tax reform and analyse what the costs for implementing the system would be or what might be the impacts on trade, jobs, growth etc.
- The DST would decrease the competitiveness of European companies, when exporting to non-EU-countries.
- Introducing a new type of tax will likely cause other countries to analyse whether to copy that tax model. Thus, implementing a DST would assumedly cause a similar type of tax triggered for European companies in non-EU-countries.
- The EU taxation system must be considered in its entirety, also when considering the taxation of digital economy. On proposing 'final technical measures to create a future-proof EU VAT system' on 25 May 2018, the Commission praised the important role played by the common VAT system in

Europe's Single Market, highlighting that "it replaced turnover taxes which distorted competition and hindered the free movement of goods and was subsequently amended to allow for the removal of checks and formalities on goods moving between Member States." Thus, the problems of a turnover tax are acknowledged also by the Commission.

- The DST poses concerns with respect to internet user location.
- An interim system would result in a massive addition to the compliance and software costs of the tax authorities and companies.
- Finally, even though the DST is described as an interim measure, the proposal contains no end-date nor a phase-out period and might therefore be expected to be in force indefinitely. Even if the directive would be deleted, it might be impossible to get all the Member States' to abolish their own legislation, if having implemented the DST.

1.2. Impact to SMEs

Even though the DST thresholds (revenue of over 750 million € worldwide, and over 50 million € within the EU) are set to target only bigger tech companies and groups, there would also be **indirect impacts to other businesses and SMEs**.

- There is no clear digital economy, only (digitalised or digitalising) economy. The DST is being justified by saying the big US tech companies do not pay their fair share of taxes. The DST could hit many EU based companies, also loss making. Also, companies considered to represent a so called "traditional economy" would also be in risk being taxed for certain services with DST, hindering the will to invest in digitalisation in the EU. In many cases, digitization involves the use of technology and automation to increase operational efficiencies or replace routine or administrative functions, which do not fundamentally change how enterprises generate revenues.
- Because of the flow down effect of most turnover-based taxes (e.g. VAT), we are also concerned that SMEs will bear much of the tax burden and will see their costs increase when advertising and/or selling their products using platforms subject to the tax. Actually, on proposing 'final technical measures to create a future-proof EU VAT system' on 25 May 2018, the Commission praised the important role played by the common VAT system in Europe's Single Market and had this to say about turnover taxes: "It replaced turnover taxes which distorted competition and hindered the free movement of goods."
- Specifically, we are concerned that, although non-EU platforms and marketplaces are in scope of the DST proposal, it is not clear how the tax will be enforced against non-EU companies. This will disadvantage EU businesses, and in particular SMEs and start-ups in favour of non-EU ones, in the following ways:
 - Much like a tariff, as DST is not recoverable, it will likely pass through in the form of higher intermediaries' fees for EU small businesses. For low margin retailing of physical goods, this will make non-EU imports cheaper than intra-EU transactions, which cannot be good for the EU economy.
 - Whilst certain online transactions are not substitutable (e.g. renting an apartment in an EU country), sales of goods through online market places are often substitutable by (cheaper) non-EU imports.

- There would also be a non-level playing field in the context of goods exported outside the EU via online marketplaces. DST on EU sellers would effectively act as an export tariff on EU small businesses relative to non-EU businesses who would not be subject to the tax on sales to non-EU customers.
- Digitalised companies and business form ecosystems, where companies are dependant from each other and also benefit from this interaction. If targeting an additional tax to some companies in the ecosystem, it is impossible to avoid impacts to the other companies as well.

1.3. The DST Might Cause Significant Double Taxation

As the current double tax treaties do not recognize such a DST, this tax would not be subject to tax credit method, thus leading to double taxation. The amount of such a double tax could be significant.

For example, for a company with an operating profit margin of 15% (which is high for low margin high investment business models) and a turnover of 1 billion euros the DST would be 30 million euros. Usually, the corporate income tax (at 20%) would be calculated from the profit: 150 million euros = 30 million euros of corporate income tax. Thus, a 3% DST on revenues would equate to 100% tax on profits, suggesting that 100% of that operating profit margin is attributable to the user. It should therefore be defined what value can be attributed to user interaction. For lack of an actual deduction or credit mechanism in the proposal wording, the DST will lead to double taxation.

2. Digital Permanent Establishment

The proposed long-term solution aims to introduce rules for concept of a digital permanent establishment (based on significant digital presence) and implementing this to the CCCTB model proposal. In addition, changes to the principles for attributing profits are introduced. As the digital permanent establishment proposal does not go into details regarding the taxation procedures, we concentrate on commenting which sort of business the directive seems to cover in practice and problems related.

2.1. List of Digital Services Covered

A company would have a digital permanent establishment in another EU country, if it performs digital services covered by the directive and exceeds the limits of significance. These limits are discussed later. According to the proposal, digital services are services delivered over the internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology. Going through the very specific list of services, it can be summed up that all business and companies even slightly digitized would be considered providing digital services.

- All software business, from gaming companies to anti-virus software, IoT, Artificial Intelligence, 3D-printing, cloud computing, big data -based business.
- Website hosting and webpage hosting, online data warehousing and online supply of on-demand disc space is provided by telecom companies, datacentres and ICT-companies.
- Automated, online and distance maintenance of programs and remote systems administration, download drivers, such as software that interfaces computers with peripheral equipment. These

include all “traditional” industry companies, which are digitalizing their business. For example, a production machine can be equipped with a relay, which gathers information from the machine. The information is analysed and used for example to make the products better or to detect a flaw in the machine, allowing repairing it before an expensive cut in production. Remote systems administration could also be electric networks, operators, automatized cars and traffic, logistic centres.

- Including accessing or downloading software (including procurement/accountancy programs and anti-virus software) plus updates to the list expands the coverage remarkably. Concerning these, the later discussed user limits can be reached fast, with a small turnover.
- All digitized media (music, movies, games, books) is included, whereas all “tangible” media is excluded. Still, a movie has the same content, no matter when you watch it (broadcasting services or downloaded from a service).

Including very specific services to the lists will make the lists age soon. Screensavers, desktop themes, jingles, ringtones etc. are included, whereas CD-ROMs, floppy disks, printed books and newspapers, CDs and video cassettes are excluded. The wide list will cause many interpretation difficulties and force the companies to adjust their systems so, that they can track their revenues divided into different categories. This will be an additional, expensive burden for the companies.

The extremely broad scope proposed by the Commission (“the supply of any digital service”) risks slowing the take-up of innovative technologies across all sectors in the EU by penalizing businesses that seek to take advantage of digital technologies. At a time when companies globally, and their customers, are benefiting from reduced costs, greater flexibility, and innovative offerings – all enabled by digital technologies – the EU risks seriously damaging its economic competitiveness by acting unilaterally on this issue.

The EU is doing a lot to protect the environment. Policies and legislation to protect the nature and help businesses move towards a sustainable economy. The digital economy is also about trying to find more efficient ways of business. The environment aspect should be taken into consideration also when analysing the digital permanent establishment proposal. For example, a newspaper is first written, and the layout is done digitally. The digital newspaper can be delivered right away to the clients. A printed newspaper needs paper shipped from another country to the printing house, printed and delivered by ships and trucks to the clients. The leftover newspapers need to be warehoused and later destroyed. The product content and production process are identical. Only the delivery is done differently – one digitally and the other using forest, fuel, big warehouses and causing waste.

2.2. Thresholds of Significant Presence

The limits when the presence is considered significant are low. A 'significant digital presence' shall be considered to exist in a Member State in a tax period if the business carried on through it consists wholly or partly of the supply of digital services through a digital interface and one or more of the following conditions is met with respect to the supply of those services by the entity carrying on that business, taken together with the supply of any such services through a digital interface by each of that entity's associated enterprises in aggregate:

- 7 million € of revenues from the digital services
- 100 000 B2C users (“users of one or more of those digital services”)

- 3 000 business contracts (“any such digital service”)

In the directive it is said that “it is essential that each threshold is set sufficiently high to safely exclude small cases where profits attributable to a digital presence would not even cover the tax compliance cost for a permanent establishment, thus to ensure proportionality of the measure while operating these three alternative thresholds.” However, it is indisputable that the thresholds are too low. For example, a game can have a price of 1 €, which would mean that the limit of 100 000 users means a turnover of only 100 000 €.

Contract is defined as a business contract if it is used for carrying on business. There is no limit on how big the client company should be or any minimum limits for the value of purchase. Internet security service to a small, 1-10 person employing firm costs approximately 20-50 € per year, summing up to a turnover of 60 000 €-150 000 €.

3. Taxation Where the Value is Created

The EC emphasizes, that an essential principle for a fair taxation is to ensure that a business pays taxes where its profits and value are created and generated. DIGITALEUROPE agrees that this established principle, also supported by the OECD, is the only reasonable way to allocate taxable profits and value. Where value is created cannot differ based on whether the good or service is delivered digitally or physically.

The digital economy relies heavily on intangible assets, which are becoming more and more the value drivers within multinational groups and which are difficult to identify and value. DIGITALEUROPE is strongly of the opinion, that the solution to this challenge cannot be that intangible assets will be given less value, as is now the suggestion with the current digital economy taxation proposals.

It is next to impossible to define and value the digital economy, companies and activities as well as data. Raw data has no material value. Any value that user data may have arises from its aggregation, organization, and analysis, which does not occur at the user’s location. Even the enterprise’s work of collecting raw data occurs through equipment and systems not located or developed in the users’ jurisdiction. The collection and analysis of data on customer preferences long predates and is not unique to digital means of doing business in any event. Therefore, we submit that the collection of data does not create value at the location of the user.

The approach proposed by the Commission goes far beyond the initial focus on user-generated value and is at odds with the aim of taxing where value is created. The extent to which user participation generates value varies greatly between different business models – see for example the analysis of different digital business models in the recently updated position paper “Corporate Tax and the Digital Economy” from HM Treasury in the UK¹. If user participation is to be one factor in determining where value is created, then this more granular kind of approach could help to avoid the negative impacts that an overly-broad definition would have on the economic benefits of digitalisation.

¹ 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

Also, if the EU agrees and announces that consumer data and participation, is of substantial value, more taxable income will be without a doubt be allocated outside of the EU. Big consumer-rich countries, such as China and India, might question the principles of income allocation. It is hard to specify why data of a European consumer is of more value than data of an Indian consumer. This would erode especially small Member States' tax bases. For example, relevant R&D-functions require skilled employees. All education costs and contributions to digitalization would be a cost to member states and companies, but there would not be taxable income to pay the costs.

4. Summary

According to the Commission, close to a third of the growth of Europe's industrial output is due to the uptake of digital technologies. Taxation should support, not hinder digitalization and digital economy, which are longstanding, explicit objectives of the EU. As pointed out in the communication paper, the world is borderless and globalized. Trying to create artificial borders to digital economy functions is impossible.

Digital technology should be seen as an opportunity also to the member states. Digitalization and automation of taxation procedures could lead to notable savings both to the tax administrations and the companies, as well as minimize the tax gap and tax evasion.

EU, OECD and the Member States have invested great effort in combating harmful practices. New evaluations should be made on how these measures have already affected the taxation and tax revenues. It would be beneficial for EU to give the new measures, and the single market, fair chance before launching new and potentially harmful measures.

1. Different set of tax rules for some companies, based on their business and location, also hitting loss making companies is **not fair taxation**. It does not support digital companies to locate in the EU. A different taxation system within the EU means more administrative costs, and it will hit the SMEs harder. Thus, does **not promote level playing field**.
2. Introducing a globally different tax system will cause expensive tax disputes, double taxation, heavy administrative costs, possible protective counter tax legislation (from US, China, India) for EU companies, and increased tax burden for EU companies. This does **not enhance proper functioning of the DSM** and is likely to **harm the competitiveness and growth** throughout the Digital Single Market (DSM).
3. Giving substantial value to the consumer data and allocating taxable income to the resident country of the consumer will lead to bigger consumer countries to demand the same principle to be used in transfer pricing. Lack of a comprehensive solution will lead to global fragmentation and enable possible tax loopholes. Thus, **not sustainable nor preventing tax avoidance**.
4. Disregarding the current global taxation system and introducing new, ambiguous rules does not lead to more **effective, efficient taxation and tax certainty**. Temporary Digital Services Tax-system requires vast, expensive changes to the systems of tax administrations and companies.

We look forward to a constructive discussion on these proposals and trust that you will remain open to the opinions of the digital technology industries in this matter. The digital economy is rapidly evolving, and digitalization can and does make a major contribution to the productivity of small businesses. We recognize the importance of an agreed reform of corporate taxation, have participated in the OECD process, and continue to do so. We fear however that hasty changes could have a serious impact on its growth, jobs and

innovation in Europe. If changes to taxation due to the ongoing digitalization of economy is planned, an international approach is the only reasonable option. **Taxation should enhance digitalization, not hinder or slow it down.**

5. Additional Remarks

5.1. Digitization and Automation of Taxation

Rather than seeing digitalization as something to be reined in through new taxation rules, digital technology should be seen as an opportunity also to the member states. Digitalization and automation as well as harmonization of taxation procedures could lead to notable savings to both the tax administrations and the companies, as well as minimize the tax gap and tax evasion. For example, the Finnish Tax Administration is the first country in Europe to combine all taxation software and processes into one system. The savings for the Tax Administration alone are estimated to be in development costs €15-20 million per year and in tax processing 100 person-years (total an approx. 6,5 % decrease in the total annual costs of the Finnish Tax Administration). Savings to companies due to the decrease in compliance costs, interest expenses and tax disputes cannot be estimated yet. Automation also minimizes the tax gap and tax evasion. The Finnish Tax Administration is also investing in software robots (estimated savings of €5 million per year, equivalent to 1,3 % of total annual costs) and AI. Similar savings could be achieved in all of EU with investments in the automation of taxation. In addition to savings both to companies and member states, automation of taxation would mean a better functioning Single Market, an appealing location for businesses to function and grow. Instead of introducing completely new set of taxation rules, which would have a huge negative impact to the tax certainty for a long time, EU could concentrate on making taxation procedures automated and digitalized, which would improve tax certainty.

5.2. GDPR

The GDPR directive came into force in May 2018. The aim is to protect the EU citizens from privacy and data breaches. Under GDPR, personal customer data is for example name, email address or IP address. Companies should limit the amount of personal data stored, to only sufficient amount of data relevant and reasonable to business, for specified purposes. All irrelevant personal data must be destroyed, when not needed anymore.

The DST directive proposal suggests that company's tax liability would be triggered based on where the user is deemed to be located.

1. Tax liability in the EU country where the consumer was when the add appeared on the user's device. No consideration would be given to whether the website or application is free of charge or where the marketing income is being generated. For example, a Swedish company would be liable to pay tax in Spain, if the French consumer watched the add in Spain, even though the Swedish company is receiving the ad income from China.
2. Tax liability in the EU country where the user uses a device to access the digital interface and concludes an underlying transaction or the user having an account allowing the user to access the digital interface and that account was opened using a device in that EU country. For example, if an Italian person logged into an accommodation services providing company A's interface, while visiting

Poland and bought accommodation for a week in Paris, company A would be liable to pay taxes to Poland, not to France. Thus, the place where the services would be used or the payments paid would not be relevant.

3. Taxable revenues are allocated in proportion to the number of users from whom data has been generated tax period or any previous year. Estonian company providing an interface, gathering information of the users and selling it would be liable to pay taxes in all the countries where the users have been at the time of gathering the data.

Both the DST and the digital permanent establishment directive proposals require a lot of location and behaviour information being gathered of customers and saved for an indefinite time. The location would be based on IP-address or “if more accurate, any other method of geolocation.”

Even if the taxation of digital economy proposals were not in breach with the GDPR, it seems to be quite a surprising course to take – to base the calculation of a new tax on personal location data, requiring saving a vast amount of personal data for taxation purposes for up to 10 years, irrelevant for business.

ABOUT DIGITALEUROPE

DIGITALEUROPE represents the digital technology industry in Europe. Our members include some of the world's largest IT, telecoms and consumer electronics companies and national associations from every part of Europe. DIGITALEUROPE wants European businesses and citizens to benefit fully from digital technologies and for Europe to grow, attract and sustain the world's best digital technology companies. DIGITALEUROPE ensures industry participation in the development and implementation of EU policies.

DIGITALEUROPE's members include in total over 35,000 ICT Companies in Europe represented by 63 Corporate Members and 39 National Trade Associations from across Europe. Our website provides further information on our recent news and activities: <http://www.digitaleurope.org>

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National Trade Associations

Austria: IOÖ	Germany: BITKOM, ZVEI	Slovenia: GZS
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