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Opinion Statement FC 7/2014 of the CFE on the OECD Discussion Draft: Addresses the tax challenges of the digital economy (BEPS Action 1)

Prepared by the CFE Fiscal Committee

Submitted to the OECD in April 2014

CFE (Confédération Fiscale Européenne) is the umbrella organisation representing the tax profession in Europe. Our members are 32 professional organisations from 25 European countries (21 EU member states) with 180,000 individual members. Our functions are to safeguard the professional interests of tax advisers, to assure the quality of tax services provided by tax advisers, to exchange information about national tax laws and professional law and to contribute to the coordination of tax law in Europe.
CFE is registered in the EU Transparency Register (no. 3543183647-05).

We will be pleased to answer any questions you may have concerning CFE's comments outlined below. For further information, please contact Mr. Piergiorgio Valente, Chairman of the CFE Fiscal Committee, or Rudolf Reibel, Fiscal and Professional Affairs Officer of the CFE, at brusselsoffice@cfe-eutax.org.

Sincerely yours,

Confédération Fiscale Européenne

Ring-fencing the digital economy (par. 10 of the Discussion Draft)

CFE strongly agrees with the statement in paragraph 59 of the Discussion Draft that "*because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy*".

We therefore doubt that solutions should be specifically designed for digital businesses. What we believe, instead, is that any relevant digital aspects should be addressed in the context of the work on other BEPS actions, such as, for example, a definition of "permanent establishment".

We believe that any definition of the digital economy, parts of which are exclusively intangible services, could not keep pace with the rapid emergence of new business models and technology, given that frequent updates of any such definition would be required, and in view of the fact that all of the above would have to go through national legislative processes. This would significantly reduce the operability of such definition.

Ottawa framework

The CFE strongly supports the key principles of neutrality, efficiency, certainty and simplicity, effectiveness and fairness as well as flexibility, as expressed in the Ottawa framework. These shall be a guidance when designing tax solutions affecting the digital economy.

Exemptions from permanent establishment status (3.1)

Many businesses that use digital methods carry on their business in a great number of different countries without satisfying the traditional OECD definitions of a Permanent Establishment (PE) and, thus, under current rules, fail to create a taxable presence in the source country.

However, we do not believe that the solution to this problem should be a major reworking of the existing rules as this might produce, as an end result, that multinationals might be deemed to have

PEs in a rather considerable number of countries with the consequent obligation to file income tax returns in those countries.

Although we recognize that finding a method by which non-resident MNEs may be liable to tax on part of their profits by another State (such as the State wherein their customers/users are based) notwithstanding the lack of physical presence and/or the lack of activities therein, which result in a PE under the current version of the OECD Model, the total elimination of Article 5(4), or the limitation of Article 5(4), may have far-reaching consequences which go beyond circumventing BEPS in the digital economy.

One could consider limiting the Article 5(4)(a)-(d) exceptions to a PE to where the maintenance of a stock of goods, warehouse etc. is in and of itself of a preparatory or auxiliary nature, and not an integral feature of the business in question.

If there is to be a change of definition, we strongly suggest that the OECD introduce a number of further examples in the Commentary so that it provide a clear-cut definition as to what sort of activities may or may not be considered of a preparatory or auxiliary nature.

Significant digital presence / virtual permanent establishments (3.2 and 3.3)

None of the proposed definitions of a new nexus based on “significant digital presence” nor “virtual PE” appears to be convincing enough, as their application would lead to substantial legal uncertainty.

The concept of “significant digital presence” creates a PE in a country for fully de-materialised digital activity if certain tests are satisfied, including if there are a significant number of contracts signed remotely by the enterprise and a tax-resident consumer of that country or the customer, or substantial payments are made by the consumers residing in the country. Because of the wording “*significant*”, there have been suggestions to introduce thresholds. In our view, however, the concept of thresholds would not fit in a direct tax solution and would, by distinguishing between digital and non-digital services, not comply with the Ottawa principles.

As we do not believe that there should be separate rules for the digital economy, we are not convinced that extending the definition of PE to “virtual” PEs will offer a workable solution. We are concerned that such concept would lead to the creation of a taxable presence for almost any activity.

Transfer pricing aspects

A substantial portion of the proposals brought forward are based on detailed transfer pricing reports and documentation being provided. Whilst being in agreement with transfer pricing and the arm's length principle, a comment/concern is the extent to which transfer pricing documentation and reporting seems to be required under the current proposed discussion draft. Requiring "uniform transfer pricing" documentation, which is further split into "country by country reporting" is very labour intensive and expensive.

Substantial focus is being given to "excessive" payments such as interest deductions and "excessive" royalty payments to low-taxed countries. The only way it seems that a business can prove that a payment is not excessive is through very detailed transfer pricing reports.

In particular our concern relates to how sustainable this is for small businesses who are genuinely trying to expand their business to another market. Having an abundance of documentation requirements might not allow business to be commercially viable. One should be careful that the BEPS reports allow for realistic measures and not fuel an over-kill in terms of documentation requirements.

Additionally, requiring transfer pricing reporting (only) when a cross-border situation arises (as domestic transactions do not impact BEPS) could create more burdens for companies dealing in cross-border transactions compared to those dealing solely in local digital transactions.

With regards to transfers of assets that seem difficult to evaluate, a "post-transfer profitability" is suggested to be taken into account. The uncertainty that this brings, unclarity as to the length of time until the moment in which the profitability can be taken into account by a tax authority goes against the Ottawa principles and is, in our view, unacceptable.

The existing transfer pricing guidelines allow for the re-characterising or for the disregarding of the taxpayer's transactional form in some exceptional circumstances. A clarification allowing taxpayers to better assess how and when transactions may be re-characterised would be welcome.

Withholding Tax on Digital transactions (3.4)

Although we can understand that the imposition of a withholding tax on the transaction may potentially solve the problem that in many cases the MNE would have no physical presence whatsoever in any other State, since it is supplying e-products, this brings with it issues such as identification of the customer and State of residence for withholding tax purposes. Furthermore it is not clear who should withhold part of the payment: the customer, the provider of the payment service, or another party.

Consumption Tax Options (3.5)

The discussion draft identifies the opportunities presented by the digital economy to make significant sales, cross-border, without creating a taxable presence in the country of consumption.

In our view, indirect taxation seems better fit to provide specific solutions to address the challenges posed by the digitalisation of the economy. However, looking at the EU, it is clear that the current VAT system still faces operability concerns.

The EU is currently changing its place of supply rules in relation to telecommunications, broadcasting and electronically supplied services within the EU from 1 January 2015 so that from that date the place of supply will be the country of the consumer rather than that of the producer.

We suggest that the OECD await the entering into force of the new EU rules and closely monitor their practicability before deciding on an indirect tax approach to the digital economy.

Impact on business, in particular SMEs

As a general comment, we would like to stress that any solution reached should ensure certainty while not creating further double taxation. The desired tax compliance should be encouraged,

without raising further complexity or distortions and excessive burden on businesses. In addition, dispute resolution mechanisms should be fostered and mandatory arbitration should be implemented in order to effectively solve any dispute that may arise from the new framework.

The digitalisation of business has widened the trade horizons for SMEs and therefore, any proposed amendments need to take into consideration the substantial number of SMEs operating in such manner. Furthermore, any amendments should pay particular attention to increased tax compliance requirements in different States which would entail a significant compliance requirement, particularly for SMEs.