



ICC Comments on the OECD Request for Input on Work Regarding the Tax Challenges of the Digitalised Economy

ICC appreciates the opportunity to provide input on the OECD consultation regarding the tax challenges of the digitalised economy. ICC fully supports a harmonised approach to ensure that international tax rules remain relevant and applicable in an increasingly digitalised global economy. ICC therefore welcomes the OECD initiative to explore the tax challenges raised by digitalisation in preparation for the interim report to the G20 in April 2018 setting out possible solutions to taxing the digital economy at international level.

General comments

The digital economy is not only revolutionising the way businesses operate but also creates new opportunities for global growth and prosperity. If nurtured appropriately, technological advances and digital connectivity can spur innovation in business models, business networking and knowledge transfer while also facilitating access to international markets. As digitalisation continues to be an important driver for global economic growth, ICC strongly believes that any discussions around the taxation of the digital economy should promote, and not hinder, growth and cross-border trade and investment. Furthermore, a collaborative approach together with business would be highly recommended, in order to fully grasp the challenges, implications, opportunities and solutions that the digital economy presents. For the ICC business community, the integrity of the international tax system is of critical importance - coherent and coordinated implementation of international guidelines are essential in establishing a consistent global tax system that better facilitates cross-border trade and economic growth.

ICC supports the OECD Base Erosion and Profit Shifting (BEPS) Action 1 Report conclusions 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 for tax purposes. The digital economy and its business models present however some key features which are potentially relevant from a tax perspective.”* It is our view that a separate taxing system for digital companies could be fraught with challenges that would create uncertainty and negative consequences for economic growth and cross-border trade and investment. The underlying issue that digitalisation presents with respect to the concept of economic presence and the interaction with the notion of permanent establishment will need to be broached at international level with a view to achieving global consensus, as opposed to counter-productive unilateral measures. As the digital economy is increasingly becoming the economy itself, any special measures for the digital economy will effectively change the international tax rules for the entire economy; therefore careful consideration, involving the entire business community, must be given to any changes.

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Responses to specific questions raised

A. Digitalisation, Business Models and Value Creation

A.1 Please describe the impact of the digitalisation process on business models, and the nature of these changes (e.g. means and location of value creation, organisation, supply chains and cost structure)

ICC believes that it is important to stay true to the basic principles of taxation as significant changes to an existing system could lead to greater disruption, which would be counter-productive for all stakeholders including businesses, governments or consumers. The rapid evolution of digitalisation has permeated many spectrums of life, including the way that businesses operate today. However, to a large degree, these changes provide alternative means to completing commercial transactions which were traditionally undertaken physically. These activities do not simply create a presence that could lead to taxation in a country where the user or buyer would be located, but rather a significant presence in the location of product and service development and cloud computing infrastructure.



Therefore, a different means of achieving the same result should neither alter the conclusion on taxable presence, nor the characterisation of income.

This aspect is an important consideration, given that the basic principle of taxation rests on the fact that activities give rise to incomes and such incomes should be taxable in the jurisdiction in which the activities are undertaken. While digitalisation results in automating activities and functions through the use of software and systems, there are identifiable locations from where the software and systems operate. This could either be the location of the hardware or the people who develop, operate, and manage the software and systems. Traditional taxation mechanics are applicable for the digitalised economy insofar as these require appropriate value to be allocated to these functions, which can be achieved through an improved and simplified application of the transfer pricing provisions. As global reporting becomes more transparent, the functional distribution should result in each country where activities are undertaken receiving an appropriate return which may be subjected to income taxation. ICC reiterates the need to ensure that national governments reach acceptable consensus such that businesses are not burdened with overbearing, complex compliance requirements or uncertainty.

B. Challenges and opportunities for tax systems

- 1 *What issues are you experiencing with the current international taxation framework? (e.g. legal, administrative burden, certainty)*
- 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?*
 - ii. *Are there any specific implications for the taxation of business profits?*
 - b. *What opportunities to improve tax administration services and compliance strategies are created by digital technologies?*

With respect to retail business, the prevalent issue relates to the absence of an effective international framework to ensure VAT collection in the market jurisdiction. Cross-border trade in goods, services and intangibles creates challenges for VAT particularly where products are acquired by private consumers from suppliers abroad. The digital economy raises policy challenges regarding the collection of VAT. For example, the proliferation of online sellers provides challenges to the collection and payment of VAT. In order to implement an effective and efficient collection process of VAT, ICC believes that administrative co-operation between countries should be strengthened. Over the past few decades *International VAT/GST guidelines* have adequately served as a preliminary response to the growth of cross-border trade and the corresponding risk of inconsistencies between different VAT systems applying different tax treatments, however, it is ICC's view that further guidance to address the evolution of the digital economy would be needed.

D. Options to address the broader direct tax policy challenges

- 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:*
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 - a. *Tax nexus concept of "significant economic presence":*
 - i. *What transactions should be included within its scope?*
 - ii. *How should the digital presence be measured and determined?*



- 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?*
- iv. *How could such a measure be efficiently and effectively implemented in practice?*

As the focus on the digital economy tax debate is on taxing remote sales by the country of consumption, if a business is reporting local sales on its local income tax return, none of the suggested options should apply. A 'significant economic presence' (SEP) concept is a fundamental change to the existing permanent establishment framework and, as the digital economy is increasingly becoming the economy itself, would represent a significant change in taxation for all businesses. It should only be considered in connection with a consideration of the rules that would attribute profit to a SEP PE. If a SEP PE is based solely on local revenue, it would seem to attract profit no higher than an entity performing limited distribution functions would earn. If the SEP taxation is truly based on net income, it seems to better align with the existing principles of taxation.

This option may have the least amount of disruption, compared to the other two options of a withholding tax or an equalisation levy. A significant economic presence could make the case for a 'permanent establishment' (PE), of which the taxation principles, including attribution of profit are sufficiently defined and implemented. It would be important to note, however, that there is still concern regarding countries seeking to tax a digital presence in the absence of any other activities. Such wide extension of the PE concept would also lead to uncontrolled double taxation.

For smooth implementation, ICC suggests that a detailed commentary on the principles under which such significant economic presence could result in a PE, together with the proposed rules to attribute profit to the SEP PE, could be provided and updated intermittently as business models evolve. This would help reduce business uncertainty and the incremental cost of doing business in a cross-border framework.

D.1 c) Digital equalisation levy:

- v. ***What transactions should be included within its scope?***
- vi. ***How could the negative impacts of gross basis taxation be mitigated?***
- vii. ***How could the threat of double taxation be mitigated?***
- viii. ***How could such a measure be efficiently and effectively implemented in practice?***

Countries where an equalisation levy has been adopted (e.g. India) have experienced greater uncertainty and cost to businesses. The levy is introduced outside of the existing income tax law, which raises questions on treaty coverage of it. A unilateral levy would therefore be a cost to business, require separate administrative intervention/compliance and make the taxation system more onerous. In India, whilst the current scope of the levy is restricted to online advertising related services, an increase in the scope would undoubtedly create greater uncertainty and disruption.

It is important to bear in mind that achieving an outcome that promotes growth and appropriately divides the tax base among countries requires a consensus based approach and any unilateral actions at a national or regional level would only create complexities for businesses with little or no effective resolutions. In addition, there is a risk of double taxation if one country imposes a tax, such as an equalisation levy, which is outside the framework of double tax agreements.

The digitalisation of the economy raises challenging issues. A rush to address those issues could result in a large part of the economy being subject to unilateral actions. There is also a likelihood that imposing an equalisation levy could increase costs to local consumers, depending on the economics. In such cases, this is clearly not the best solution, as it simply increases the tax burden on local consumers. ICC holds that there is an urgent need for countries to collectively discuss and



resolve this issue through mutual consensus, as opposed to unilateral actions. ICC reiterates that any solutions should have broader adoption by countries to allow for a seamless application for businesses.

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As was discussed during the work on BEPS Action 1, there is insufficient understanding of the incidence of direct and indirect taxes and ICC believes that this would be worth researching further as work on the taxation of the digital economy progresses. Annex E of the Action 1 Final Report addresses the economic incidence of the options to address the broader direct tax challenges of the digital economy. That analysis, however, proceeds from the assumption that changes are adopted in a global coordinated step such that relative tax rates are unchanged. In the absence of global coordinated adoption, the incidence of taxation might be very different. ICC offers its knowledge and experience to assist in presenting business views on further issues and discussion drafts in this area.



The International Chamber of Commerce (ICC) Commission on Taxation

ICC is the world business organization, whose mission is to promote open trade and investment and help business meet the challenges and opportunities of an increasingly integrated world economy.

Founded in 1919, and with interests spanning every sector of private enterprise, ICC's global network comprises over 6 million companies, chambers of commerce and business associations in more than 130 countries. ICC members work through national committees in their countries to address business concerns and convey ICC views to their respective governments.

The fundamental mission of ICC is to promote open international trade and investment and help business meet the challenges and opportunities of globalization. ICC conveys international business views and priorities through active engagement with the United Nations, the World Trade Organization, the Organisation for Economic Co-Operation and Development (OECD), the G20 and other intergovernmental forums.

The ICC Commission on Taxation promotes transparent and non-discriminatory treatment of foreign investment and earnings that eliminates tax obstacles to cross-border trade and investment. The Commission is composed of more than 150 tax experts from companies and business associations in approximately 40 countries from different regions of the world and all economic sectors. It analyses developments in international fiscal policy and legislation and puts forward business views on government and intergovernmental projects affecting taxation. Observers include representatives of the International Fiscal Association (IFA), International Bar Association (IBA), Business and Industry Advisory Committee to the OECD (BIAC), Business Europe and the United Nations Committee of Experts on International Cooperation in Tax Matters.