



EUROPEAN COMMISSION
DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
Direct taxation, Tax Coordination, Economic Analysis and Evaluation
Company Taxation Initiatives

Brussels, 18th October 2017

Doc: Platform/29/2017/EN

PLATFORM FOR TAX GOOD GOVERNANCE

CHALLENGES IN TAXATION OF THE DIGITAL ECONOMY AND OBJECTIVES OF THE REFORM

Disclaimer:

This is a Commission services working paper prepared by DG TAXUD for discussion purposes. It does not represent a formal Commission or Commission services position or policy. The paper is therefore without prejudice to any position which may be taken by the Commission in the future

Contact:

Secretariat Platform, Telephone (32-2) 29.64.208

E-mail: taxud-platform@ec.europa.eu

Context and challenges

Major strides have been made in improving the corporate tax framework in recent years. Member States have agreed to a series of new rules to tackle aggressive tax planning and increase tax transparency, and have intensified their international stance on tax good governance. In the area of State aid control, the Commission has carried out a general enquiry into the tax ruling practices of Member States and is investigating tax rulings and schemes that grant preferential tax treatment to some companies. In the area of Value-Added Tax, the Commission is also addressing the challenges posed by the digital economy with its proposal on e-commerce. Negotiations are advancing on the Common Consolidated Corporate Tax Base, which was re-launched by the Commission in 2016.

As already identified in the Commission's report in May 2014¹, the international tax framework needs reform to effectively capture the value created from new business models— unfortunately, it has so far proved difficult to agree on the solutions at global level, as is evident from the OECD report in October 2015². The Commission wants an ambitious EU agenda on the matter and a common EU approach to ensure that the digital economy is taxed effectively, in a way that ensures fairness, supports growth and does not result in competitive distortions.

The digitalisation of the global economy is happening fast and permeates almost all areas of society. Businesses of all kinds now derive much of their value from intangible assets, information and data. Close to a third of the growth of Europe's overall industrial output is already due to the uptake of digital technologies. In 2006, only one digital company was among the top 20 firms by market capitalisation; in 2017, already 9 digital companies were among the top 20. Between 2008 and 2016, the revenues of the top 5 e-commerce retailers grew by 32% on average per year, compared to 1% in the entire EU retail sector grew.

Corporation taxation is based on the principle that profits should be taxed where the value is created. Two important questions tax rules need to answer are 'where to tax', i.e. rules that determine what triggers a right to tax in a country, and 'how much to tax', i.e. rules that determine how much profit is allocated to country. Today's permanent establishment rules determine the threshold of activity that needs to be carried out in a country in order for a business to be taxable in that country. These rules are largely based on physical presence. Today's transfer pricing rules are used to attribute the profit of multinational groups to the different countries. These, too, were developed for the traditional economy.

International tax rules were originally designed for "brick and mortar" businesses; for the digitalised economy, these rules are inadequate. They result in a poor congruence between taxation and where value is created. The challenge is how to establish and protect taxing rights in a country where businesses can provide services digitally with little or no significant physical presence despite having a commercial presence. How to attribute profit in new digitalised business models heavily driven by intangible assets, data and knowledge, which are difficult to value?

¹ See European Commission Expert Group on Taxation of the Digital Economy Report, May 2014.

² See Addressing the Tax Challenges of the Digital Economy, OECD Base Erosion and Profit Shifting Project Action 1 Report, October 2015.

Furthermore, intangible assets can be fairly easily shifted from one jurisdiction to another, which opens significant tax planning opportunities. The high mobility of intangible assets allows more digitalised companies to benefit from certain tax regimes and push down their tax burden.

Both the outdated rules that do not properly capture digital activities and the relative ease with which more digitalised companies can engage in aggressive tax planning result in competitive distortions. These distortions manifest in various ways. They create an unlevel playing field between different types of companies, notably between those that are more digitalised and those that are less. They also create an unlevel playing field across the Single Market, as some Member States feature more prominently in tax planning schemes than others. In the worst case, a significantly lower tax burden can enable larger digitalised companies to drive out competitors from their markets or hinder potential new entrants. This is inefficient and hurts growth and welfare.

Without EU action there is a risk of uncoordinated unilateral measures that would fragment the single market and hamper the EU's competitiveness. The outdated rules together with the rapidly progressing digitalisation of the economy raise concerns that Member States' tax bases could gradually disappear. This and the perceived unfairness of the situation increase pressure on policy makers to act. Uncoordinated measures can result in double taxation, increased compliance costs and other cross-border tax barriers. At the same time, competitive distortions – e.g. the dominance of very large market players - hinder the creation of start-ups or young innovative companies to scale up. All this hampers the development of new digital solutions, which are important to open up new opportunities for everybody. The challenge is to make the most of these digital opportunities to ensure Europe's competitiveness, while ensuring fair taxation.

Objectives

A comprehensive and modern approach to the taxation of the digital economy is needed to meet the goal of fairer and more efficient taxation, and to support EU growth and competitiveness through the Digital Single Market. This approach should be driven by the following objectives:

- **Fairness** – Ensuring that corporate profits are taxed where the value is created. It is necessary to maintain a level playing field and a system that is resilient against abuse so that all companies pay their fair share whether they are large or small, more or less digitalised, EU or non-EU based.
- **Competitiveness** – Creating the right tax environment for the scaling-up of start-ups and businesses to flourish in our Single Market. To improve the competitiveness of the EU, we need to remove existing obstacles and avoid creating new tax barriers to the emergence of new businesses that foster innovation and create jobs.
- **Integrity of the Single Market** – Converging towards a common solution that avoids unilateral measures that would destabilise the functioning of the Single Market. Uncoordinated national measures will lead to fragmentation of the Single Market, further distortions and tax obstacles that will prevent companies from growing and investing in the Single Market.

- **Sustainability** – Ensuring the corporation tax system is future-proofed and sustainable in the long-term. As traditional business models become increasingly digitalised, Member States' tax bases could gradually disappear if the tax rules are not adapted to capture new digitalised business models. If not remedied this will lead to the tax burden being increased elsewhere.

Questions

Platform members are asked to share their experience and express their view on the following areas:

- What issue do you see with the current international tax framework vis-à-vis the digitalised economy? In particular, what are the implications of highly digitalised business models and their value chain on existing tax bases, structures of tax systems and the distribution of taxing rights between countries?
- Are there competitive distortions you see/experience as a result of the weaknesses in the tax system? What is the impact of these distortions on companies and on Member States? What could be done to eliminate them?
- How far have BEPS and the recent EU initiatives addressed the tax challenges raised by digitalisation?
- Do you agree that there is a need for a common EU response?
- Do you agree with the objectives set out above?