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Comments on the Public Consultation Document “Addressing the Tax Challenges of the Digitalisation of the Economy”

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Taxand welcomes the opportunity to provide comments on the Public Consultation Document "Addressing the Tax Challenges of the Digitalisation of the Economy" published on 13 February 2019. We would like to share our thoughts, based on our experience in advising multinational enterprises, focusing on some of the questions set forth in paragraphs 87 and 110 of the Public Consultation Document.

Paragraph 87 – Question 1: What is your general view on those proposals? In answering this question please consider the objectives, policy rationale, and economic and behavioural implications.

The consultation document and the presentation of the three proposals seems to be at a very early stage of development of a long-term solution, and any of the proposals, if adopted as the way forward, would require significant further development. The proposals seem conceptually simple, but they are all legally and technically complex – and in their mechanics would represent a significant change from the existing international tax framework and, in particular, a departure from the arm's length principle which focuses on allocating profit to where significant functions are. Looking outside the functions performed by a company (e.g. users and data) would make profit allocation significantly more complex and debatable. This may eventually lead to more uncertain tax positions and a rise in disputes and double taxation.

We do not believe that a specific tax system addressed to the companies that are highly digitalised may represent the best long-term solution. The first point of concern is that business models are constantly changing and in the near future all businesses will be highly digitalised from healthcare, insurance, fintech and automotive. Digitalisation is the key concept of every multinational. Accordingly, there will be no more "some highly digitalised business models" but every business model will be digitalised. Therefore, our concern is that there will be much more debate on how to identify the business models and enterprises captured by the new rules. The second point of concern is to carve out the envisaged new set of rules from the companies that despite having a highly digitalised business model, are significantly and physically present in the different jurisdiction. In such a case the TP model should continue to be applied.

Paragraph 87 – Question 2: To what extent do you think that businesses are able, as a result of the digitalisation of the economy, to have an active presence or participation in that jurisdiction that is not recognised by the current profit allocation and nexus rules? In answering this question, please consider: (i) To what types of businesses do you think this is applicable, and how might that assessment change over time.

As a starting point, the assumption that there could be large multinationals that may create significant business in a jurisdiction without creating any physical presence, must be further investigated. If there is a physical presence, the current TP rules can address the profit allocation.

We support the principle that the profit of a multi-national should be taxed where it creates value at its heart but in this perspective and in the digitalised age the allocation of any profit or revenue to the user or market jurisdiction must be carefully ascertained. In principle, we agree with the proposition that some interactions with users can create value for certain highly digitalised business, but, the "user participation proposal" does not seem to address the problem. In principle, the data cannot create any added value. The key issue in any business model is unlocking value in the big data with analytics. Moreover, focusing only on the users without considering the interaction with the platform seems not to be entirely correct. The collection of data is linked with an interaction among three main factors: the data => the interface =>

the users. In principle, the interface may play a major role because a good interface (a web site or mobile app) will encourage the users to utilise it and in such a way the multinationals may get more data. With the data, multinationals may further develop the interface that is able to involve more users and getting more data. Accordingly, an inherent value in the collection of data and users may simply not be isolated from the interface and its development.

The "user participation proposal" should take into consideration not only the value of the data deriving from the interaction of a human being (person) but also the data that in the near future will be provided by the "things" in the new Internet of Things environment. In this respect, it has also to be considered that the necessity to collect a huge amount of big data in order to profile clients does not seem to be an imperative in the near future. The massive use of artificial intelligence for profiling will be performed with a much less requirement to collect data (see the speech held by Facebook COO in Davos 2019).

Finally, as far as the mechanics is concerned, paragraph 23 statement does not seem to be fully in line with the current development. Paragraph 23 reads as follows: "The proposal acknowledges the difficulties in using traditional transfer pricing methods for determining the amount of profit that should be allocated to a user jurisdiction. For example, it dismisses the idea that the value created by user activities can somehow be determined through the application of the arm's length principle, e.g. through hypothesising the user base as a separate enterprise and asking what return it would receive at arm's length in its dealings with other group entities". There are new startups that work in the personal data collection field exploiting the GDPR data portability right. They act on behalf of their users to request the personal data from the controllers (i.e. companies to which the users provided their personal data). They exploit users' personal data and give their users a fee representing part of the value generated by their data. Therefore, through these new startups operating in the personal data collection field, the current TP methodologies may well capture the value to be allocated to the user jurisdiction.

Also, the "marketing intangible proposal" does not seem to entirely capture the new development in the marketing sector. Paragraph 39 reads as follows "With consumers increasingly online, consumer-facing businesses need to be online, which in turn reduces the need for a physical presence or changes the nature of the physical presence in a way that reduces the market jurisdiction's taxing rights". According to the last published book of Seth Godin, one of the most reputable worldwide marketing experts, the future of any multinational may be the so called "smallest viable market" that implies a strong physical presence in a market jurisdiction and the diminishing impact of social media.

Paragraph 87 – Question 2: To what extent do you think that businesses are able, as a result of the digitalisation of the economy, to have an active presence or participation in that jurisdiction that is not recognised by the current profit allocation and nexus rules? In answering this question, please consider: (ii) What are the merits of using a residual profit split method, a fractional apportionment method, or other method to allocate income in respect of such activities?

Rather than focusing on any merits of these methods, we would emphasise the very real technical and practical difficulties that any of these methods would rise to on a multilateral basis. Mechanically, the issue of double taxation would be very difficult to address under the current bilateral treaty system and the current framework for dispute resolution would be wholly inadequate.

Nevertheless, any of these methods may only work on a global basis. Of course, the formulary apportionment of profits it is the simplest way to apply the proposals, with the need to find someone in charge of the formulas. Who would take on such a role? Moreover, if the countries agree that the residual profit should be determined on a global basis this would imply that also the remuneration of the routine function should be agreed on a global basis that is not the case.

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Paragraph 87 – Question 4: What could be the best approaches to reduce complexity, ensure early tax certainty and to avoid or resolve multi-jurisdictional disputes?

As indicated in paragraph 82, new nexus requirements would be necessary to implement the profit allocation proposals. This could be achieved by amending or supplementing the definition of "permanent establishment" under Article 5 of the OECD Model Tax Convention on Income and on Capital and by implementing such changes both in the existing bilateral tax treaties and in domestic law.

In order to reduce complexity, to ensure tax certainty and to avoid multi-jurisdictional disputes, the changes to the definition of "permanent establishment" should be as much as possible: (i) based on a large consensus, ideally all the countries members of the Inclusive Framework on BEPS (IF countries) should agree on such changes; (ii) standardised, in the sense that the wording of such changes should implemented in the same way in all the existing bilateral tax treaties signed by IF countries and in the IF countries' domestic law; (iii) simultaneous, in the sense that such changes should be implemented in a synchronised manner in all the bilateral tax treaties signed by IF countries and in the IF countries' domestic law.

From a bilateral tax treaty perspective, such an ambitious goal should be achieved by including the amendments to the definition of "permanent establishment" in the Multilateral Convention and qualifying such changes as a minimum standard.

Taxand is the world's largest independent tax organisation with more than 400 tax partners and over 2,000 tax advisors in 48 countries. If you have comments or questions, please feel free to contact any of the following:
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