Tax and the digitalised economy

International Tax | Large Corporate

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Addressing the challenges posed by the digitalisation of the economy continues to be tackled by countries on a unilateral basis and by the OECD which is seeking to develop a global long term solution. The CIOT has recently responded to consultations by the UK government and the OECD on proposals to tax large, multinational digital businesses.

In the Budget 2018, the government announced that it would introduce a UK digital services tax (DST) from April 2020; a consultation document followed.

The OECD published a consultation document on 13 February 2019: *Addressing the tax challenges of the digitalisation of the economy* which aimed to progress the conversation around the impact of digitalisation on nexus and profit allocation rules and set out the continuing work towards a consensus-based long term global solution.

The CIOT met with HMT and HMRC in February 2019 to discuss the UK's proposed DST and also the developments in this difficult area emanating from the OECD. Subsequently to that meeting we responded to both consultations.

The CIOT strongly supports the aim of consensus-based long-term reform of the international tax system to address the perceived challenges arising from the digitalisation of the economy. We welcome that the UK government also reiterated that its long-term objective is a global reform of the international tax system. In our responses, we encouraged all those involved to re-double the efforts to achieve an early consensus on the way forward because we are increasingly facing an international tax landscape of unilateral actions being taken independently by countries (including the UK). We understand that different countries have different aims and objectives in relation to the digitalised economy, but unilateral measures inevitably lead to less alignment of tax bases globally, resulting in double taxation and a significant compliance burden for businesses and, consequently, stifle

economic growth and innovation. They may also result in retaliatory measures, and, perversely, the differences between tax systems resulting from unilateral actions are likely to give rise to arbitrage/tax planning opportunities, thus increasing the problems caused.

UK Digital Services Tax (DST)

The overall aim of DST is to ensure that digital businesses pay tax reflecting the value they derive from the participation of UK users. We broadly agreed with the analysis in the consultation document on how interaction with users can create value for certain highly digitalised business, and that the lack of taxation of user created value is a challenge to fairness and acceptability of the system. However, a revenue-based tax such as the DST is a blunt instrument that cannot accurately represent the tax on the profits related to user based value on all businesses on which it is imposed and this tax will inevitably over-tax some companies and under-tax others.

Our response focused on the practical difficulties that will inevitably arise from the tax: our overall conclusion is that in practice the government will have to rely on companies to arrive at a 'best estimate' of the amount of the DST payable based on a just and reasonable estimate of the UK revenues liable to the DST.

We welcomed at the meeting the clear indication of the necessary pragmatic approach to the DST by the government, and this is reflected in the consultation document. However, we said that it is important that the legislation itself is clear and sets out this pragmatic approach.

The inevitably inequity that will arise between taxpayers, and the unstable tax base, make it very important that this tax is clearly a temporary measure.

Our full response can be found on the CIOT website.

OECD consultation: Addressing the tax challenges of the digitalisation of the economy

The OECD consultation document set out proposals involving two pillars: pillar 1 that focusses on the allocation of taxing rights and pillar 2 that addresses remaining BEPS issues around how taxing rights on income generated from cross-border activities in the digital age should be allocated among countries.

The over-arching objective of the proposals under pillar 1 is to devise a system which recognises value created by a business's activity or participation in user/market jurisdictions that is not recognised in the current framework for allocating profits.

We commented that all of the proposals present enormous challenges and a departure from the existing principles around how multinational enterprises (MNEs) are taxed on their global profits and, in particular the arm's length principle. We suggested that the next step should be to arrive at political agreement as to how the value created by user participation should be allocated; following on from this, the OECD can explore the technical and practical details of the agreed way forward.

The underlying similarity in each of the proposals under pillar 1 is that there would be a move to a lesser or greater extent towards a mechanism relying on fractional apportionment of part of an MNE's profits. We said that there is no reason to reject fractional apportionment as a matter of policy, and the CIOT does not have any ideological opposition to it. However, in our view, fractional apportionment would not work within the existing framework of bilateral treaties and the current dispute resolution mechanisms. All of the proposals presented in the OECD's consultation document would require treaty changes and a substantial multilateral agreement / regulatory framework to be able to operate effectively. We emphasised the very real technical and practical difficulties that would arise under the current international legal framework. For example, 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 (which is already under significant pressure) would be wholly inadequate.

With regard to pillar 2, we said that we understand the remaining concerns around the risks that continue to arise from structures that shift profits to entities subject to no or low taxation, and welcome a global response to this issue in preference to a proliferation of unilateral measures. However, we suggested that time should be allowed to see the full impact of the BEPS measures that have been agreed to date and are in the process of being implemented around the world, before it is decided whether this additional proposal is required. In many respects the proposed measures seem to be addressing issues that have already been addressed and the existing measures should be permitted time to take effect and the results seen.

The OECD consultation document recognises the practical challenges around disputes that will arise and the potential for double taxation. However, it does not give sufficient attention to the interaction between pillar 1 and pillar 2: this will require careful consideration and would be very complicated. For example, how can you establish what rate of tax has been paid on a particular receipt in a country if globally MNEs are not necessarily being taxed on a particular receipt in that country – because it is allocated to a user jurisdiction?

We also said that, given the complexities around developing these proposals and implementing them, it is important to reflect on likely possible outcomes. We envisage that tax rates will converge and governments will subsidise activities outside of the tax line in much less transparent ways, meaning that there could be complex rules with little benefit.

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