AmCham EU's position on the Tax Challenges of the Digital Economy

Executive summary

- **The economy has become digital**. The wider economy has transformed into a digital economy, adopting new technologies, new communication tools and new ways of analysing and employing data to create innovative business models and better business methods.

- **The EU should engage with other tax jurisdictions**. A unilateral EU approach to the direct taxation of multinational companies could create double-taxation problems and provoke concerns about protectionism if it is not coordinated with the ongoing multilateral tax discussion at the OECD level. Tax concerns could undermine the potential benefits of a new EU-US trade agreement.

- **The OECD is the best place for discussions about international tax policy**. The OECD is currently analysing Base Erosion and Profit Shifting (BEPS) concerns at the request of the G20, including residence-source issues associated with the taxation of multinational companies. A proposal that might raise taxes in one country or region could give rise to unexpected and a contentious shift in states' corporate tax revenue and also create concerns about double taxation. The OECD is best place for a coordinated and coherent approach to the taxation of multinational companies. We commend the efforts of the EU expert group on taxation of the digital economy to ensure compatibility with the ongoing OECD BEPS process.

- **The expert group should consider risks to the EU single market**. The European Commission appointed expert group should issue firm guidance for EU states, defending the principles of the EU single market, particularly the free movement of goods and services. Recent legislative initiatives in some EU countries, including limits on cross-border transactions and national 'ring fences' around data, clearly violate the principles of the single market, creating new national barriers that could slow economic activity and innovation across the EU. The efforts of the EU in the indirect tax field should find resonance in the direct taxation area.

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AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Aggregate US investment in Europe totalled €1.9 trillion in 2012 and directly supports more than 4.2 million jobs in Europe.

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Introduction

This document highlights AmCham EU's views on taxation of the digital economy. A European Commission appointed expert group is currently reviewing this subject with the aim of delivering recommendations in the first half of 2014. In the below position we outline key issues we believe the European Commission should consider during its discussions on taxation of the digital economy.

The economy has become digital

The European Commission appointed expert group has been asked to examine 'taxation of the digital economy.' But what defines the digital economy? What are the criteria that determine if a company is digital? Are all companies that adopt new technologies like the Internet, sophisticated software tools and data-driven business methods actually digital companies?

The OECD has found that digital technologies are enmeshed in all aspects of the economy, with firms across all sectors using the Internet and other new technologies and data analysis to redefine traditional business methods (see *'Measuring the Internet Economy: A Contribution to the Research Agenda,'* 2013).

A closer look at various sectors shows how pervasive digital tools have become, blurring the lines between different parts of the economy. The music, film and publishing industries, for example, have migrated to digital production and distribution methods. Newspapers transmit articles on the Internet, derive an increasing share of revenue from online advertising and use web-specific tools and formats to attract readers. Financial firms, including banks and insurers, use network technologies as the backbone of their businesses and to which the appropriate regulatory environment still applies. Credit card transactions, car insurance quotes, and the exchange trading of shares are conducted online or via sophisticated technology platforms. The pharmaceutical and medical sectors are also digital, using data analysis and advanced robots to create new chemical compounds, modeling their efficacy long before drug trials begin. Hospital networks store and share patient data electronically and use data analysis in areas such as tracking equipment and facilities to drive better patient care. The industrial sector also uses digital tools to gather and analyse data in order to improve the utilisation and efficiency of equipment and manufacturing processes.

Even the parts of the economy that might seem unlikely to be described as 'digital' have been transformed by new network technologies. Mining, manufacturing and agriculture have become digital industries, using networked trading platforms to buy and sell commodities and finished goods in a global marketplace. Energy companies can now monitor and maintain their generators remotely in real time. Even the automotive sector has incorporated advanced technologies like global-positioning devices, Internet radio and computers that analyse and regulate performance and aid maintenance. These are not just add-on features. Car companies that have been in business for over a century are currently developing vehicles that can drive themselves, using sophisticated software, data analysis and real-time communication tools. These 'computers on wheels' show how new technologies are deeply integrated in all aspects of our economy.

Some suggestions about taxing the digital economy have focused on the value of data and have considered whether a 'data tax' would be desirable. Recent data tax proposals assume that raw data has value by itself while ignoring the longstanding use of customer data, for instance, in traditional industries.

The examples cited above demonstrate the wide range of scenarios in which data is transferred across borders. None suggest that the data has intrinsic value – rather the value is created in the way in which the data is processed either before or after it is transmitted. Even if it were accepted that raw data has a value in and of itself, it is clear that this value cannot be determined with reference to the number of bits that storing or transmitting the data consumes – some raw data sources may be very large in size, but of very little value, whereas other data sources may be very smaller in size, but of significant value. Indeed, using software, the same data could be compressed into a smaller number of bits without diminishing its value. Equally, firms may not be able to, or simply may not benefit from, the possession of such data, so that no income is generated by it. Consequently, a 'data tax' would be inequitable and be highly subjective, undermining the faith in and relative predictability of the tax system.

Further, as can also be seen from the examples above, the use of data to build new businesses and drive efficiency is pervasive and a tax on data would raise the cost of a critical business input and impede data flows, potentially slowing the pace of innovation and data-supported commerce. This would have a negative effect on the wider economy and SMEs, not just a few multinational companies.

Therefore, rather than singling out the digital companies, the EU should focus on encouraging the use of digital technologies across the whole economy and completing the Digital Single Market which could result in a 4% increase in EU GDP by 2020[1].

The EU should engage with other tax jurisdictions

Changes to tax policies in one country can have consequences in other states. For example, tax cuts can create competitive pressures, attracting businesses across borders. In other instances, targeted tax increases can impede foreign investment or favour domestic firms, creating a protectionist effect. Neither case is desirable, making multilateral tax cooperation a key element of global economic policy-making.

Some EU officials and legislators recently have called for new taxes on a select group of US-based multinational companies. Like most multinational companies, these firms pay significant amounts of corporate taxes, particularly in their home countries. Moreover, a full picture of a corporation's contribution to the public purse should take into account not only corporate income taxes but other taxes such as payroll and local tax contributions. In addition, because the digital economy is pervasive, what would be the basis for singling out companies for additional discriminatory taxation? The potential for double taxation and arbitrary additional levels of single taxation that could arise would be contrary to established tax rules and adversely impact some of the world's major technology companies, with resulting adverse impacts on their customers and the economy.

[1] Copenhagen Economics, *The Economic Impact of a European Digital Single Market*, Brussels, 2010. http://www.epc.eu/dsm/2/Study_by_Copenhagen.pdf

The prospect of EU-led tax discrimination could have negative consequences for the current EU-US trade talks on the Transatlantic Trade and Investment Partnership (TTIP). Income taxation typically is not included in regional or bilateral trade agreements, but it could be a source of friction in the TTIP negotiations if the EU adopts a separate approach to digital taxation, particularly if this has a disproportionate effect on US companies.

The OECD is the best place for discussions about international tax policy

The need for a multilateral approach to changes in international tax-policy makes the OECD the best place for discussions about taxation for multinational companies. The OECD launched its BEPS review in July 2013, following a formal request from the G20 finance ministers and for the first time ever in tax matters, non-OECD/G20 countries are involved on an equal footing. The OECD's report on the Digital Economy will be issued in the coming year and will offer a series of possible policy changes.

The OECD has a long track record as an effective place for multilateral tax coordination, both in the development of its Model Tax Convention and in its more recent work targeting tax havens. The OECD's work in this area is crucial to maintaining tax equilibrium both among OECD members and non-OECD members that closely follow OECD developments. We commend the efforts of the EU expert group on taxation of the digital economy to ensure compatibility with the ongoing BEPS process.

The current EU discussions on whether multinational companies are paying their 'fair share' of taxes raises difficult questions about residence-source approaches to taxation. As mentioned previously in this document, multinationals pay significant amounts of corporate and other taxes, particularly in their home countries (where they are resident), so changes to the apportionment of taxation that increase tax revenue in some countries may well have a commensurate impact in other states. Potential policy changes could also create new concerns about double taxation, causing friction between tax authorities.

Some commentators have suggested that the EU intends to develop a 'united front' before the OECD concludes its BEPS review. This sort of coordination makes sense for an integrated economic bloc, but it should not pre-empt or preclude international cooperation. The goal of multilateral tax coordination is not to see one country gain revenue at the expense of another, but to ensure a consistent rules-based approach to taxation, creating certainty for companies operating across borders and predictable revenue streams for government budgets.

The expert group should consider threats to the EU single market

The European Commission appointed expert group should scrutinise proposed tax-policy changes that jeopardise the EU single market. Some EU states recently have suggested limits on cross-border transactions and barriers to the transfer of data within the EU. Both constitute limits to the free movement of goods and services, key principles enshrined in the EU Treaty.

While the Treaty is not a matter for multilateral discussion, AmCham EU supports the completion of the single market, which increases the vitality and dynamism of the EU economy. Conversely, obstacles to the single market, particularly sudden policy changes, create concerns for foreign companies operating and investing in the EU.

One example is the recently-passed legislation in Italy that requires Italian buyers of digital goods and services to transact only with an Italian VAT registered company. This legislation will negatively affect companies based in other EU countries, including many US companies (or their EU subsidiaries) doing business throughout the EU. This is a clear violation of the EU's single market rules and has a negative impact on companies across the bloc. It creates additional bureaucracy and may prevent foreign businesses from benefiting from the VAT simplification regime on digital services to private consumers due to apply as of 2015. It would, in all instances, introduce discrimination between business-to-business and business-to-consumer transactions and undermine the simplification efforts put in place by the EU VAT package on place of supply.

In recent years we have seen worrying developments singling out the digital economy, which had an impact on the single market. EU governments have imposed new taxes on the telecoms sector to fund other sectors, public policy ambitions and/or contribute to budget deficits. Examples of such taxes include:

- France and Spain imposed taxes on telecommunications operators to compensate for the removal of advertising from public service television. In France the tax was set at 0.9% of the revenues (received from subscribers) of telecoms operators which exceed €5m/year. In Spain the tax was set at 0.9% on the gross revenues of telecommunications operators that develop activities at national level or in at least two autonomous communities.

- Hungary's 'crisis tax' levied on the three following sectors: telecoms, energy and retail chains.

Against this worrying backdrop, we believe it is important that the European Commission prioritises consistent national tax policies across the member states to avoid any short-term, protectionist proposals that risk harming development of a thriving digital single market in Europe.

Likewise, national barriers or 'ring fences' to data flows, which have been described as a potential means to implement a data tax, would create barriers to cross-border commerce. Such a tax would stifle business innovation and negatively affect economic activity across the EU.