ITI Promoting Innovation Worldwide

ITI Response to European Commission's Inception Impact Assessment for a Digital Levy

11 February 2021

The Information Technology Industry Council (ITI) welcomes the opportunity to respond to the European Commission's Inception Impact Assessment (IIA) for a digital levy. ITI is the premier voice for the global information and communications technology (ICT) industry. Our over 70 member companies include the world's leading innovators around the world across the ICT spectrum. We advocate on behalf of our members for policy and regulatory environments that foster innovation and maximise all the benefits that ICT companies provide, including economic growth, job creation, and the tools to solve the world's most pressing social, economic, and environmental challenges. We work closely with our partners in government, international organisations, the business community, and civil society to achieve these objectives.

Our members have consistently supported the negotiations at the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework, including through regular technical engagement and the development of Principles for a Solution in the OECD's Project for Addressing the Tax Challenges of the Digitalisation of the Economy. Global tax policy challenges require global tax policy solutions, which is why nearly 140 governments and more than a dozen observer organisations have committed to the negotiations taking place under the auspices of the Inclusive Framework. We have welcomed the European Union's (EU) commitment to reaching a multilateral, consensus-based solution to the tax challenges arising from the digitalisation of the global economy, and encourage the European Commission to continue to promote multilateral engagement as the sole means of addressing the underlying tax policy challenges identified by participating governments.

The Commission's decision to launch public consultations on an EU-level digital tax is, however, fundamentally at odds with the EU's public support for the negotiations and risks undermining the significant progress participating governments and the OECD have made during the past several years. Additionally, the advancement of a unilateral EU measure that, by design, would be imposed in addition to Member States' pursuit and implementation of a multilateral solution poses a direct and inherent challenge to that multilateral cooperation and progress. It is in the spirit of the EU's commitment to multilateralism that we urge the Commission to refrain from further consideration of a digital levy and instead to redouble its efforts in support of the OECD/G20's Inclusive Framework project.

Support for a multilateral, consensus-based solution

We acknowledge the rationale that drives the OECD/G20 Inclusive Framework's work to update existing tax frameworks to reflect the contours of the 21st century economy, and as noted earlier, we have actively supported ongoing negotiations from their inception, including through participation in several public consultations and the release of principles intended to guide negotiators' efforts.[1]

[1] ITI has submitted responses to several public consultations, including those concluded in December 2020, December 2019 (Pillar Two), and November 2019 (Pillar One).

Global Headquarters
700 K Street NW, Suite 600
Washington, D.C. 20001, USA
+1 202-737-8888

Europe Office
Rue de la Loi 227
Brussels - 1040, Belgium
+32 (0)2-321-10-90

info@itic.org
www.itic.org
@iti_techtweets

Our global membership – which features industry leaders headquartered in the United States, EU Member States, India, Japan, Korea, and other significant EU trading partners – views the negotiations taking place under the auspices of the Inclusive Framework as the best forum for addressing the tax challenges arising from the digitalisation of the global economy. The proliferation of unilateral measures has already contributed to the fragmentation of the global tax system, and an inability to reach consensus will result in further fragmentation of our global tax system and other effects such as the slowing of economic growth and the augmentation of diplomatic and trade tensions.

The detrimental impacts of targeted, unilateral measures

Since the European Commission introduced the first of what would become known as digital services taxes (DSTs) in 2018, unilateral measures have not only proliferated but have also grown in scope, as dozens of governments have introduced measures – many of which take a form similar to the 2018 EU proposal – that deviate from longstanding international tax principles such as neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility. Ever more expansive digital taxes have also been introduced in markets like India, explicitly targeting the sale of virtually all goods and services online by non-resident firms and bringing European industries into scope. The increasingly widespread application of targeted, unilateral taxes is perpetuating a trend that serves to undermine a functioning international tax system and compromise the predictability that system has afforded companies in Europe and beyond to conduct business globally.

DSTs and similar unilateral, targeted tax measures share several problematic characteristics, such as their application to gross revenues instead of net profits; multiple revenue thresholds and other stipulations that target largely non-resident, globally engaged companies; and a narrow scope of covered digital activities that largely excludes domestic competitors from liability.

First, taxing corporate revenue, rather than income, is inconsistent with international tax principles – as reflected, for example, in the OECD Model Tax Convention on Income and on Capital, the United Nations Model Double Taxation Convention, and over 3,000 bilateral tax treaties. This approach appears to penalize low-margin and loss-making companies and subjects affected companies to potential multiple taxation and significant compliance costs.[2] The structure of taxes on gross revenue also means the burden of the tax most likely falls on in-country consumers.

Second, subjecting companies to an EU-wide corporate tax without regard to whether or to what extent they have a permanent establishment in-country is inconsistent with the international tax laws vis-à-vis bilateral tax treaties as well as international tax principles reflected in the OECD model tax treaty and other instruments, and will, like taxing revenue, create the risk of multiple taxation, significant compliance costs, and greater uncertainty. For example, companies will need to engage in significant re-engineering of their internal business and financial reporting systems to ensure that they can accurately capture required information and comply with the DSTs. Companies will also need to include new filing and audit components on accounts in these jurisdictions, which creates

[2] To illustrate how DSTs as gross receipts taxes compare to corporate income taxes, a DST of 3% applied to a company with a 10% profit rate equates to a 30% effective corporate income tax rate, with limited to no availability for credits. This is applied in addition to corporate income taxes paid by the company. The double taxation and subsequent effective corporate income tax rate are especially impactful to companies with lower profit margins and companies with losses.

legal and financial risks. To the extent that these taxes differ in scope and thresholds, those compliance costs increase. Further, there will be very high audit uncertainty, which will lead to additional disputes and subsequent costs for taxpayers and tax administrations alike. Companies and Member State governments are already preparing to commit resources to the reconfiguration of systems to adopt new rules pursuant to the Inclusive Framework's conclusions, which benefit from the context of a multilateral agreement, the withdrawal of unilateral measures, and enhanced dispute prevention and resolution mechanisms. The EU's advancement of a unilateral tax would need to be implemented above and beyond what all participating governments ultimately agree to at the OECD.

Beyond generating inconsistencies and fragmentation in the international tax system, these unilateral deviations have impacts that reverberate in other policy areas, most notably trade. As mentioned earlier, the narrow scope of covered services and revenue thresholds operate together to single out a subset of large, primarily foreign companies for taxation. Such a tax effectively operates as a trade barrier by causing in-scope companies to lose out on business to local rivals that do not meet the revenue thresholds or the strict business model definitions in the tax, establishing a difference in treatment between foreign and domestic competitors. The overall impact hurts the domestic market – in this case the EU Single Market – by making it all the harder for businesses and consumers alike to benefit from productivity-enhancing goods and services, and contributing to a less friendly business environment. As noted above, this detrimental impact on European firms grows as jurisdictions outside of Europe impose even more expansive national taxation measures. It also drives the risk of tax and trade retaliation as governments respond to the deliberate targeting of companies headquartered within their borders.

Finally, the broad rationale underpinning the introduction of such measures is predicated on a misguided premise that effective tax rates (ETRs) for digital companies are lower than those for companies operating in "traditional" industries. A 2018 ECIPE study found the Commission's "selective use of firms and the obscure way of estimating effective corporate tax rate" did not allow for a comprehensive understanding of international taxation, and in fact masked the comparable diversity of profitability levels and overall tax burdens among digital and traditional companies alike.[3] The ECIPE analysis further observed that the Commission's 2018 findings "underestimate the effective tax rates of digital companies by about 20 percentage points if average tax rates are taken into consideration."[4] These conclusions are echoed in a 2018 Copenhagen Economics paper that found the Commission's claims of under-taxation can be attributed to digital companies' substantial investments in research and development, which benefit from public policy tools to encourage such investments.[5] These analyses clearly suggest that the Commission should not base policy action on these narratives of under-taxation.

---

[3] Matthias Bauer, Digital Companies and Their Fair Share of Taxes: Myths and Misconceptions at 7, ECIPE Occasional Paper No. 03/2018, https://ecipe.org/publications/digital-companies-and-their-fair-share-of-taxes/?chapter=all.

[4] Ibid., 8.

[5] Helge Sigurd Næss-Schmidt et al., The Proposed EU Digital Services Tax: Effects on Welfare, Growth and Revenues, Copenhagen Economics (September 2018), https://www.copenhageneconomics.com/dyn/resources/Publication/publicationPDF/7/457/1537162175/copenhagen-economics-study-on-the-eu-dst-proposal-13-september.pdf.

Undermining OECD negotiations

Taking into account stated political support for negotiations at the OECD, the Commission's decision to move forward at this time with public consultations to inform the development of a digital levy effectively pre-empts the ongoing negotiations at the OECD – to which all EU Member State governments are actively contributing. The language of the IIA itself further presumes that the Commission will consider as insufficient any multilateral, consensus-based solution to emerge from those negotiations. From a practical perspective, it is impossible for the Commission to determine how it would complement measures that have yet to be fully be developed. Any unilateral actions – or premature indications that an outcome will not be viewed as sufficient – undermine this essential work.

The Report on the Pillar One Blueprint reiterates that "Pillar One seeks… to result in the removal of relevant unilateral measures."[6] It follows that jurisdictions should not seek to take actions in direct contravention of the goals of the multilateral project they openly support. We strongly encourage the EU to maintain its support of the 139 participating member jurisdictions and G20 leaders working diligently towards a mid-2021 timeline for reaching a multilateral, consensus-based agreement, including by refraining from advancing a measure at odds with this overarching goal.

Responding to COVID-19

The IIA cites as an objective of the digital levy to "support a more stable medium-term outlook." We note as well that the "Recovery Plan for Europe," published by the European Institutions last year, identifies a digital levy as a source of funding. Our companies recognise that, like jurisdictions around the world, the Commission is seeking additional revenue sources to account for spending in response to the pandemic. For all economies, the challenges posed by COVID-19 are extraordinary. Further, the COVID-19 crisis has accelerated technology disruption and digitalisation, which were already transforming the way companies manufacture, operate supply chains, innovate, and reach customers in global markets. Responding to this crisis demands enhanced multilateral cooperation across all fronts – not unilateral tax policies that pit countries facing similar challenges against one another.

We also note guidance issued early in the pandemic by international organisations such as the OECD and the International Monetary Fund (IMF) that emphasizes business continuity and cautions governments against undertaking reforms "that would risk undermining tax certainty after the current crisis abates."[7] Any proposal must be grounded in long-standing international tax principles. Significant changes to global tax laws should adhere to clear and consistently applied tax policy principles and should be designed to be sustainable and prospective. ITI has long agreed with the OECD that it is both unrealistic and poor policy to try to ring-fence the digital economy – a position that the OECD has also expressed as a key underpinning of its work to address the tax challenges

[6] OECD, Report on the Blueprint for Pillar One at 11 (October 14, 2020), http://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-one-blueprint-beba0634-en.htm.

[7] IMF, Tax Law Design Considerations When Implementing Responses to the COVID-19 Crisis at 2, https://www.imf.org/~/media/Files/Publications/covid19-special-notes/special-series-on-covid-19-tax-law-design-considerations-when-implementing-responses.ashx?la=en.

presented by the digitalisation of the economy.[8] Even after the Inclusive Framework has reached a conclusion on these issues, the Commission's future consideration of tax policy should reflect the digitalisation of the entire economy, rather than attempt again to ring-fence what it considers as the digital economy or distinguish for tax treatment purposes between levels of digitalisation.

Conclusion

Our members are committed to the success of the work taking place under the auspices of the Inclusive Framework, and see a multilateral, consensus-based solution as the only sustainable outcome to the tax policy challenges arising from the digitalisation of the global economy. We look forward to continuing to engage with the OECD and members of the Inclusive Framework as they advance their work to resolve the political and technical questions. We would encourage the European Union to reiterate its active support for the Inclusive Framework's negotiations by discontinuing its consideration of a digital levy and redoubling its efforts to ensure that EU Member States and other jurisdictions participating in these critical conversations have the support they need to develop and implement a solution.

[8] OECD, Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report at 54 (October 5, 2015), https://www.oecd.org/tax/beps/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report-9789264241046-en.htm ("[B]ecause 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.").