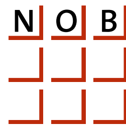

de Nederlandse Orde van Belastingadviseurs

The Dutch Association of Tax Advisers

Committee on Legislative Proposals

Amsterdam, March 6, 2019

Subject: OECD's Public Consultation on 'Addressing the Tax Challenges of the Digitalisation of the Economy' (13 February 2019 – 6 March 2019)

Ladies and Gentlemen,

The Dutch Association of Tax Advisers (the "Association") has taken interested note of the consultation launched by the OECD on 13 February 2019 with a view to devising measures for addressing the challenges that the increasingly digitalising economy (the "Consultation"). The OECD has invited interested parties to respond sending an email to TFDE@oecd.org in word format. The Association is pleased to make use of this opportunity in the form of this letter.

The main points to which the Association wishes to draw attention in this position paper are the following.

- The OECD notes that digitalized businesses are difficult, if not impossible, to ring-fence from more 'traditional' businesses. This means that any proposal in the Consultation has to take into account the effects it may have on all types of businesses, as the proposals will apply universally. The proposals appear to stem from jurisdictions' frustration with the perceived lack of fair taxation of digitalized businesses, and the Association wishes to caution that any proposal should be carefully evaluated and also considered in view of non-digitalized businesses and the impact on such sectors.
- In order to keep transfer pricing and the arm's length principle in place, it is suggested to attribute functions to a digitalized nexus, and subsequently allocate profits to such attributed functions. Such attributed functions will be difficult to benchmark as these are not performed in the market jurisdiction. Rules for attribution of functions should be clear and easy to apply in practice, in order to avoid tax disputes.
- The proposals in the Consultation hint at a global profit split, or global apportionment. Should such a mechanism be decided as the desired result, such a mechanism should take into account losses incurred, especially since heavily digitalized businesses are able to sustain multi-year losses while still being (considered) a viable business.

The Committee on Legislative Proposals of the Dutch Association of Tax Advisors uses the expertise of their members to provide solicited and unsolicited commentary on legislative proposals (and their preparatory stages). Important touchstones are legal certainty (including retroactive effect), compatibility with law, feasibility, effectiveness and efficiency, administrative burden and implications for the investment climate.

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- The minimum taxation rules potentially set aside long established principles of international taxation and would possibly allow jurisdictions to set aside tax treaties unilaterally. Such rules also hit at the core of jurisdiction's sovereignty to set their own tax rates and determine the taxable basis. Within the EU, such rules would likely have to be tied to a principle purpose test in order for such rules to be compatible with EU law.
- The proposals entail a substantial deviation from existing transfer pricing and profit allocation rules and are inevitably expected to lead to significantly more tax disputes, which may even result in unresolved double taxation due to the lack of mutual agreement procedures, acceptance of corresponding adjustments and/or acceptance of arbitration. A global approach, such as safe haven provisions, multilateral APAs or a one-stop shop could be considered as safeguards for taxpayers' rights.
- As a final comment, the Association likes to note that it is remarkable that the options mentioned in Chapter 2 of the Consultation are limited to three alternatives only. In particular the Association wonders why the option of a withholding tax is not further considered, as a withholding tax could cater for the intended allocation of taxing rights to market jurisdictions, as expressed in the Consultation, and would fit better in the existing international taxation framework (and as such it would be less prone to the risk of causing double taxation).

The Association examines some of these issues in more detail below.

1 Double taxation/distortion

Risks in respect of double taxation and distortion of business models

The Consultation puts forward different options of addressing nexus, profit determination as well as profit allocation, with the question whether these options are fit for purpose. In this respect, the five Ottowa princples of taxation, i.e. neutrality, efficiency, certainty & simplicity, effectiveness & fairness and flexibility can be considered a helpful yardstick to measure the proposals at hand, with a focus on double taxation and the potential distortion of business models.

Proposals should strive for general application

The Consultation rightfully puts forward the statement that the rules should not be limited to 'digital businesses' but should in fact apply also to more traditional businesses. In line with the conclusions from the BEPS Action 1 report on the digital economy being (potentially) impossible to ring-fence and also considering the neutrality principle, this makes sense. For example, more traditional businesses, such as for example credit card companies, stores with a loyalty program, etc. have similar benefits from user participation and the information they gather from their customers.

In addition, practically it will also be difficult to ring-fence particular business models. For example, under the UK's proposed digital services tax, 'social media platforms' will be taxed, which leads to implementation issues as a social media platform has a number of sources of revenue such as targeted advertising, general advertising and sponsored posts/content and the gathering, analyzing and sale of user's behavior and other information. As also noted above,

there any many ‘traditional’ businesses that have aspects to their business model comparable to purely digital businesses. The question is then raised whether such businesses, under the user participation method, apply a profit split to their whole businesses or only to the digitalized aspects? If it is the latter, how should such businesses be separated for businesses in integrated business lines?

In this respect however, the user participation proposal, as well as the marketing intangibles proposal albeit to a lesser extent, limit the application to certain types of businesses or stages of business development. This ‘digital’ application would in practice result in companies which are almost similar being subject to different rules and taxation differences, with tax becoming an unwanted driver in business decisions on what type of business to run. Hence, a widely applying concept potentially more in line with the significant economic presence proposal would be preferable over the proposals with more limited application.

Nexus extension

The question is raised in paragraph 87 whether companies can have an active presence or participation in a jurisdiction without falling under the current nexus rules, which is the case. With current nexus rules stemming from a more ‘physical’ time, it is logical that the related concepts of physical presence (either through a fixed establishment or through a permanent representative) without modification would not capture a similar digital presence within a jurisdiction. And this digital presence as well as digital supply is only expected to increase with both the development of technology and the congruence of different industries with a clear focus on being close to the customer (through its data), triggering for example increased digital services. Such an extension of the source country taxation rights will require an update to both domestic law as well as treaties to mitigate double taxation and ensure single taxation, as recognized in the Consultation document. However, this is only relevant to the extent that profit can be allocated, which is a more contentious area for which several proposals are made in the Consultation and in which respect some comments are included below. From an efficiency perspective, as well as certainty & simplicity, and also considering the additional (criminal) penalties and tax costs an unreported permanent establishment can bring, if there would be an extension of the nexus concept it would be recommendable to include an exception in case either there is already a taxable presence within the country (e.g. a LRD) at which level the profits can be taxed, if there should be no taxable income attributable[1], or if the activities are below a certain threshold (see also next paragraph in this respect).

Profit determination and allocation

Underpinning the profit allocation discussion is a concern that currently source countries are not receiving their ‘fair share’ of the income generated from digital businesses. While this can be debated, in the below the focus will be on the proposed approaches.

Under current transfer pricing rules, profits are allocated based on the functions performed, which in turn affect the assets used and risks assumed. This principle is also clear in the modified nexus approach, which ties the granting of a beneficial tax regime specifically to the actual functions performed. Under the proposals in the Consultation, such functions are

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[1] Please note in this respect that potentially also losses may be incurred.

'attributed' to the taxable nexus, rather than that these are actually performed.[2] As a general consideration, due to the inherent restriction or focus of profit allocation in light of transfer pricing to different parts of a company, the currently considered deeming provisions can still result in a significant breach of the neutrality principle (not to mention the general concept of transfer pricing) as this can stimulate business decisions motivated by tax considerations.

While the good part is that the Consultation looks at the location where value is created, it should be noted that value by itself does not mean profit and no specific consideration is given to the funding, expenses incurred and management and control of the related risks which all influence this. As a result, when converting this value creation to related profit, the answer may be that there is actually a loss incurred (or even the company itself may be loss making on an overall basis)[3]. Having such losses is likely not anticipated by the source countries and in practice companies that run (multi-year) losses in multiple jurisdictions are faced with significant audit discussions with local tax authorities. This is also in practice one of the benefits of a routine / limited risk model even if the company as a whole is loss making, as this limits local controversy and related inefficiencies (including potential double taxation and loss utilization limitations).

It should also be noted that any metric used to determine profits should take into account different business models and margins. Not all users have the same level of participation and not all platforms have the same revenue level per user. Any metric would have to take into account such differences and cannot be based on a deemed fixed return per user (e.g., a tax related to the number of clicks, unique views, etc. does not do justice to value created). Further implementation issues have to be considered such as determining the location of users (that mask their physical location by means of VPNs). Or, whether content providers on a platform, which could be (un)paid content providers or 'influencers', who would receive advertising revenue (either directly from sponsors or indirectly via sharing of advertising revenue with the platform), are considered to be in scope of the rules. These are not the platform itself, but still (indirectly) earn advertising revenue via the platform.

Similarly, also the global approach to the determination of profit, while ultimately a good approach, will have an inherent increased risk of double (non) taxation as OECD and non-OECD countries now could have a potentially far bigger difference in their definition of taxable income. From the decisions taken in the MLI, it is apparent that only a small number of jurisdictions have opted for effective dispute resolutions, which is especially clear in the choices made for article 17 (corresponding adjustments) and Part IV (arbitration) and the low uptake of such mechanisms. In this respect, besides robust dispute resolution mechanisms, it can also be considered to include ordering rules to limit the related impact. Such considerations are also relevant to multinational groups that already applied existing transfer pricing rules to determine the profits of existing group entities, that would have to be reviewed if functions performed by such entities are now deemed to be performed by another entity or in another jurisdiction.

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[2] The Association notes that any deeming of functions, without such functions actually being performed, is expected to lead to taxpayer uncertainty and tax disputes.

[3] One of the key factors of some of the digitalized businesses which are considered in the Consultation is that even the 'successful' companies can run significant sustained losses for a significant amount of years, with unsuccessful ones even never making break even.

Also from a taxpayer's perspective, any proposal that provides for deeming of functions, and corresponding profits, without very clear guidance upfront will inevitably lead to disputes. One could think of application of an IP regime, which already leads to substantial discussions even in case only one jurisdiction is involved. Although the Consultation suggests that there may be safe harbor provisions (in paragraphs 24.2. and 24.3) or that taxpayers can obtain upfront certainty (paragraph 49), such agreements would have to be multilateral and binding upon all jurisdictions involved. Moreover, while dispute settlement in itself is already a time consuming and costly exercise, taxpayers are likely to be confronted with unresolved double taxation due to a lack of acceptance of corresponding adjustments and/or a lack of arbitration. A solution could be a global APA, or implementation of a 'one-stop shop', whereby the group files its tax returns in line with the current principles and that any apportionment of profits is handled between tax administrations, rather than between the taxpayer and local tax administrations.

Last, in order to improve efficiency and limit double taxation risks, the inclusion of a threshold may also be considered. Such a threshold could for example relate to a minimum amount of revenue to be earned within the country (on a group basis, but taking into account the exception to the nexus as mentioned above). In order to avoid a potential cliff effect, only the excess above the threshold could be included.

2 Minimum taxation and EU Law

The Association raises concerns as to the compatibility of the global anti base erosion rule with EU law obligations stemming from the freedom of establishment under Article 49 and the free movement of capital under Article 63 of the Treaty on the Functioning of the European Union ("**TFEU**"). In the view of the Association, the income inclusion rule, the undertaxed payments rule and the subject to tax rule may either constitute a *de jure* or *de facto* discrimination against internationally controlled enterprises. It follows from constant case law of the Court of Justice of the EU ("**CJ**") that a low taxation in another EU Member State as such can not justify a discriminatory tax measure. In *Eurowings* (ECJ 26 October 1999, C-294/97), for example, the CJ explicitly held that *"[a]ny tax advantage resulting for providers of services from the low taxation to which they are subject in the Member State in which they are established cannot be used by another Member State to justify less favourable treatment in tax matters given to recipients of services established in the latter State*". According to the CJ, such compensatory taxation "*prejudices the very foundations of the single market*". In the *Cadbury Schweppes* case, the CJ has confirmed this case law in the context of CFC-legislation (ECJ12 September 2006, C-196/04). Hence, a low taxation in another EU Member State cannot, as such, be a justification for differential treatment in the field of company taxation. Differential treatment by reference to a low taxation in another EU Member State is only allowed in case of an artificial arrangement in the meaning of the CJ's case law.

The above case law is not restricted to intra-EU investment relations. The proposed rules could also be scrutinized in the investment relations between EU and non-EU Member States based on the free movement of capital provision under Article 63 TFEU. It is true that the latter provision would no longer apply (and hence the proposed rules could be applied without further EU law constraints) if the scope of the proposed rule would be limited to groups of companies only (see for example CJ 13 November 2012, C-35/11). However, since non-EU payments could be rechanneled through EU Member States in such a case, the effect of a

(possible) distinction within the proposed rules between EU and non-EU payments may be questionable.

Based on the above, the Association takes the view that the proposed rules should be supplemented with an anti-tax avoidance test in order to comply with EU law standards. The proposed rules should apply only in case of artificial arrangements in the meaning of the CJ's case law. This means that an overall assessment must be conducted, based on all relevant facts and circumstances. The relevant factors would include at least the organizational, economic or other substantial features of the group of companies to which the taxpayer in question belongs and the structures and strategies of that group (see to that effect CJ 20 December 2017, C-504/16). In the view of the Association, the proposed rules should furthermore, for the sake of legal certainty, provide for one or more safe harbor rules, particularly by referring to the degree of economic substance of the recipient of the payment.
To sum up, in the view of the Association, the proposed rules should be supplemented with a case-by-case tax avoidance test and, in addition, with one or more safe harbor rules.

Practical implementation considerations within EU – principle of subsidiarity

As direct taxation falls outside the exclusive competence of the European Union, the subsidiarity principle foresees that coordinated action at the EU level in this field may only be carried out if issues cannot be appropriately dealt with at the level of each individual Member State. According to the Consultation, the proposed anti-base erosion measures aim at addressing "the continued risk of profit shifting to entities subject to no or very low taxation". Implementing measures at the EU level that go beyond the minimum standards already provided for in the EU Anti-Tax Avoidance Directive ("**ATAD**") would therefore first require evidence that such minimum standards have not adequately addressed the risk of profit shifting – one of the primary objectives of the ATAD. In addition, it is reasonable to expect that any proposal that would define a minimum taxation level in absolute percentages would raise concerns about a potential infringement to the EU Member States' sovereign powers to design their own direct tax system.

It should further be noted that national parliaments of EU member states also have the possibility to object any draft legislation proposed by the European Commission by issuing a reasoned opinion (the so-called yellow card procedure under which the national parliaments of EU Member States can object to a draft legislative act on grounds of the principle of subsidiarity).

Any form of minimum taxation inevitably leads to a shift in taxing rights and steps away from existing principles (such as the principle of taxation at the location of value creation). Especially paragraph 106 of the Consultation illustrates the potential willingness to set aside such principles. This would impact jurisdiction's sovereignty and possibilities to set their own tax rates. The Association wishes to raise its concern that opening up this route may lead to unforeseen outcomes in other fields than digitalized businesses, since tax treaties apply to all types of income and not only to specified sectors.

Especially setting aside article 7 of the OECD Model Convention creates uncertainty and sets aside long-established principles. It is true that by doing this, source jurisdictions effectively are able to tax income attributable to a presence that the source jurisdiction considers a

permanent establishment under its domestic rules, but is currently not able to tax as the digitalized business activity does not constitute a permanent establishment under tax treaty principles. However, non-taxation or insufficient taxation (to the extent that the latter is actually able to be defined), should in the view of the Association be resolved via anti-hybrid rules (e.g. PE mismatch rules) and/or the principle purpose test in the MLI and newly concluded tax treaties, not by unilaterally setting aside the tax treaty.

If such a minimum taxation would be pursued, such rules would have to take into account the overall tax position of the non-resident entity. For example, the effective tax rate could be lower due the existence of carry-forward losses, tax credits or other factors that affect its effective tax rate. Moreover, in designing such rules, the OECD's acceptance of IP regimes (as evidenced by the recommendation of the modified nexus approach), should also be taken into account.

Yours sincerely,
The Dutch Association of Tax Advisors

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Chair, Committee on Legislative Proposals