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Subject: **EY Comments on the EU Public Consultation for a Fair & Competitive Digital Economy – Digital Levy**

Introduction

We appreciate the opportunity to submit these comments on behalf of EY on the European Commission's public consultation of 18 January 2021 on a fair & competitive digital economy – digital levy.[1] In this document, we will provide our perspective on the considerations relevant for deciding on whether and how to design a digital levy. In doing so, we will touch upon the issues and considerations underlying the questions posed in the questionnaire. Given the nuance that we feel is needed for a careful and thorough consideration of the issues, it is not possible to fully and fairly present our perspectives through responses to the questionnaire itself.

In the following section, we will start by looking at how digitalisation is impacting businesses and the environment in which they operate. After that, we will continue with a discussion of the tax issue. In the third section, we will explain the importance of a thorough understanding of the business realities to the development of an appropriately targeted design for tax measures in this area. In the section that follows, we will discuss the different options that were suggested by the Commission in the consultation. We will end with some closing remarks.

The environment

The rapid pace of digital innovation, the significant demographic shifts and the increasing demand for a more sustainable world create megatrends influencing and transforming economies, the business environment and wider society. The COVID-19 pandemic has further amplified these developments.

Governments are shoring up their economies impacted by the pandemic through record stimulus packages and introducing new policies and legislation to drive a sustainable recovery. Businesses are re-evaluating their supply chains and reimagining how their workforce operates. Technological innovation is at the heart of this sustainable recovery. Like all governments and economic blocks, the EU is focused on this as well. This focus is illustrated by the key objective of making Europe Fit for the Digital Age and conditioning the access for EU Member States to grants and loans from the Next Generation EU recovery package on a certain level of investment in technological innovation.

Digitalisation impacts all of our lives and all businesses. As we have seen during the pandemic, digital means were at the heart of many businesses' ability to shift from physical engagement among employees and with customers, to virtual engagement. It made it possible for people to continue to buy services and products, even though shops

[1] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12836-A-fair-competitive-digital-economy-digital-levy.

and restaurants were closed. Education could continue even though schools and university campuses were closed. And it made it possible for people to stay in touch with their friends and loved ones, even though it was not possible to physically meet. Without digital means, the economy would not have been able to respond with such agility to the pandemic.

The Organization for Economic Cooperation and Development (OECD) in the context of Action 1 of the Base Erosion and Profit Shifting (BEPS) project recognised that "the digital economy is increasingly becoming the economy itself."

Also when assessing the impact of the COVID-19 pandemic, there is no apparent bright-line distinction between the effects on highly digitalised and less digitalised businesses. Indeed, some highly digitalised businesses saw their market shares and revenues grow significantly. In some cases, these higher market shares also led to high profitability. However, other highly digitalised businesses suffered greatly from the pandemic, such as the travel industry. Moreover, some categories of less digitalised businesses also saw their revenues and profits increase significantly, such as supermarkets as consumers could no longer go to restaurants. A key question is how these effects will change once restrictions are lifted. These nuances need to be taken into account when linking the effects of the pandemic to any post-pandemic policies that are being developed. In other words, when designing sustainable tax measures, policy makers should look beyond the current disruptions caused by the pandemic.

The fundamental rules governing the EU internal market, such as, for example, the competition rules, aim to guarantee a healthy and level competitive environment for businesses. No undertaking should be treated differently by the business tax framework in a way that provides for a competitive advantage for that business or for other businesses in similar positions. This means that new tax rules should not discriminate by sector if this would result in an advantage that would be incompatible with the internal market rules on fair competition.

The tax issue

The digitalisation of the economy is creating disruptions and opportunities in many areas. One of these areas relates to tax. The international tax rules were originally conceived in the early 20th century, when trade was becoming increasingly global, while profit generating activities were still "bricks and mortar". Political leaders supporting digital tax solutions indicate that, in the current environment, businesses can have significant economic engagements with consumers and users in a jurisdiction, without having any physical presence in such market jurisdiction. As taxation rights in the existing bilateral tax treaties are linked to having a physical presence in a jurisdiction, this prevents market jurisdictions from implementing domestic rules to tax profits from these remote activities. This has led to a strong push from the public and politicians around the world to either introduce a form of taxation for these activities that is not restricted by bilateral tax treaties (such as Digital Services Taxes or DSTs) or to create the potential for taxing the profits from such activities by changing existing bilateral tax treaties. Internationally it is widely recognised that the second option, which would be based on a global consensus on a new division of taxing rights, would be preferable over a proliferation of unilateral DSTs. EY agrees it would be beneficial to have a globally coordinated solution.

There is wide recognition that only a global solution provides tax certainty and reduces the potential for multiple taxation. The consultation raises the question of whether and how digital tax measures should be implemented and coordinated in the absence of a global solution. In addition, the consultation raises the question of what type of digital levy could be introduced to generate own resources for the EU to pay back part of the loans connected to the Next Generation EU Recovery Fund.

Scope

In reaching a global solution, the issue of the businesses in scope is a point on which perspectives of countries vary. During the recent public consultation by the OECD/G20 Inclusive Framework on BEPS on the blueprints on Pillar One and Pillar Two, commentators put forward many positions and arguments in relation to scope. Some argued for a wide scope of the measures (e.g., involving all businesses with a certain level of profitability and meeting certain economic indicators). For the businesses in scope the proposal results in destination based taxation. Therefore, when deciding on the scope, policy makers need to answer a number of important questions:

- in what situations and to what extent is a destination based taxation justified?
- how to distinguish between businesses subject to destination based taxation and businesses subject to the traditional allocation of profits?

Commentators also argued that, if a narrow scope is taken, an unlevel playing field might result. This could cause economic disruptions in the situation where similar activities with different delivery models (e.g., digital versus non-digital) or performed by different types of businesses, are treated differently for tax purposes. As noted above, in the context of the EU, the rules on competition also play a relevant role in this regard. Hence, in reaching a solution on scope a principled approach will be required for the delineation of businesses for which destination based taxation is considered fit for purpose and businesses for which the traditional allocation of profits is more appropriate.

If global agreement is not yet reached, coordination at the EU-level would be welcome to reduce the proliferation of unilateral DSTs. However, it would also be important for the EU to continue to actively support efforts to reach a full global consensus solution. An EU solution should use similar building blocks as the global solution that is under discussion, being a profit-based solution that prevents double taxation and leads to the withdrawal of the unilateral DSTs already introduced. An EU solution that would introduce an EU-wide revenue based tax would likely not strengthen the internal market, but would hamper local innovation in the EU.

The importance of understanding business realities in order to develop an appropriately targeted design

In the context of scope, it is important to distinguish between different business models. There are common business models in which the residual profits related to the digital or other consumer facing activities are already fully or partially allocated to, and taxed in, the local market under the current international tax system. This is the case when, for example, consumer facing intangibles are owned and exploited in the local market, or when digital activities are undertaken in a specific local market. It also can be the case that the marketing activities performed outside the local market receive no, or a limited, return, which may effectively mean that the residual profits generated by the marketing activities are allocated to the local markets. If a business can prove that it uses this type of local business model (i.e., where residual profits that relate to a certain market are already allocated to and taxed in that local market), the business (or the relevant segment) should be out of scope.

It has sometimes been suggested that these local-to-local business models are exceptional, in particular when it comes to highly digitalised businesses. However, a closer look at domestic or regional markets reveals a different reality. Recent analysis by the Dutch Central Bureau for Statistics, for example, confirmed that Dutch platforms are mainly targeted on the local market.[2] From our experience, it appears that the same is true for other Member States. Therefore, considering a local-to-local exemption is important, also as a way to ensure that small and medium sized enterprises are not overly burdened by any measures introduced.

The suggested solutions in the consultation document

As we noted earlier, a global agreement on re-allocation of profits is the preferred solution for tax certainty and stability. As part of this agreement, revenue based DSTs would need to be withdrawn.

In relation to a possible introduction of a top-up tax, legislators are of course sovereign to determine the level of taxation of businesses in their own jurisdiction. However, a top-up tax targeted only at a specific sector should be carefully analysed, as it could be at odds with the principle of equity which is one of the cornerstones of the Unions internal market.

In addition, the Commission suggests the possible introduction of revenue-based taxes and taxes on business-to-business transactions. Using revenues as the basis for taxation ignores the significant investments that are made to grow a business and the fact that many digital business activities are not profitable in the early years because of such investments. This is particularly relevant for digital start-up companies that invest in innovation. Levying taxes on businesses that are not yet profitable would raise the costs for innovation and digitalisation and would hamper innovation. This raises the question why revenue and transaction based taxes would be considered despite their distortive effects. It may be that such taxes or levies are considered as a substitute for profit based taxes to avoid the constraints of bilateral tax treaties. This is also why these taxes trigger strong negative reactions from treaty partners.

Aside from the question how revenue and transaction based taxes impact the relationship with treaty partners, there are some similarities between these taxes and excise taxes. Excise taxes are often used to discourage certain activities, for example by raising the costs of particular goods or activities. Using taxes with similarities to excise taxes for activities that governments actually want to encourage, such as for example digital

[2] Centraal Bureau voor de Statistiek, *Meer inzicht op online platformen in Nederland*, 14 September 2020, cbs.nl/nl-nl/achtergrond/2020/38/meer-zicht-op-online-platformen-in-nederland.

innovation, would be counterproductive. This would be contrary to the overarching economic policies of many governments and the EU. Imposing tax on revenue from specified activities also should be rejected because it could lead to cascading taxation.

Closing

The environment for business taxation in the 21st century, including for any form of digital levy, should appropriately value what has been established in the past through international cooperation, while also embracing the fact that innovation and new global consensus can deliver solutions to remaining or new challenges. It is imperative that tax policies of the future are built on clearly delineated objectives and strong evidence, recognising the importance of clarity, equality, impartiality, predictability and administrability. Businesses need an equitable, stable and predictable tax environment to be able to invest, innovate and with that, deliver the economic and societal transformation in the way desired by policy makers. Only in such an environment can business play its part in fulfilling the future ambitions of the EU.

In order to achieve this, it will be very important for business to be able to provide input at all stages of the legislative process. EY welcomes the opportunity to discuss these issues in greater detail and to continue to participate in the dialogue as the Commission and country policymakers advance the work on this important subject.

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