Unequal taxation in a digital world

– an update to the 2017 Report

pwc

Foreword

In 2017 we commissioned PwC to produce the report «Unequal taxation in a digital world – a challenge for the Nordic media industry».

It outlined in detail the then current tax framework, the digitized business models compared to more traditional business models, the development in digital technology and its impact on the economy, and the challenges resulting from the current tax framework's failure to capture digitized business models. The report pointed out that the then current tax framework's failure to capture digitized businesses lead to a common perception that the taxation system was unfair and that taxing rights were allocated mostly to the advantage of multinational players. Furthermore the 2017 report outlined the work carried out by the OECD and others up until May 2017.

The 2017 report concluded that the developments in the media market and the lack of global consensus to coordinated solutions was causing major competition challenges for the Nordic media industry.

This follow-up report provides a review and assessment of developments, mainly within the EU and OECD, since the first report was published. It also points the way forward. All views and conclusions in the report are those of PwC.

We believe the need to address the issue of taxation is even more urgent now, as the media is only the first of many sectors that will be affected by this unfair competition. And the tax base of the Nordic countries will continue to be eroded if nothing is done.

Oslo, November 2018

TU Medier i Sverige DANSKE MEDIER finnmedia

MEDIEBEDRIFTENES LANDSFORENING

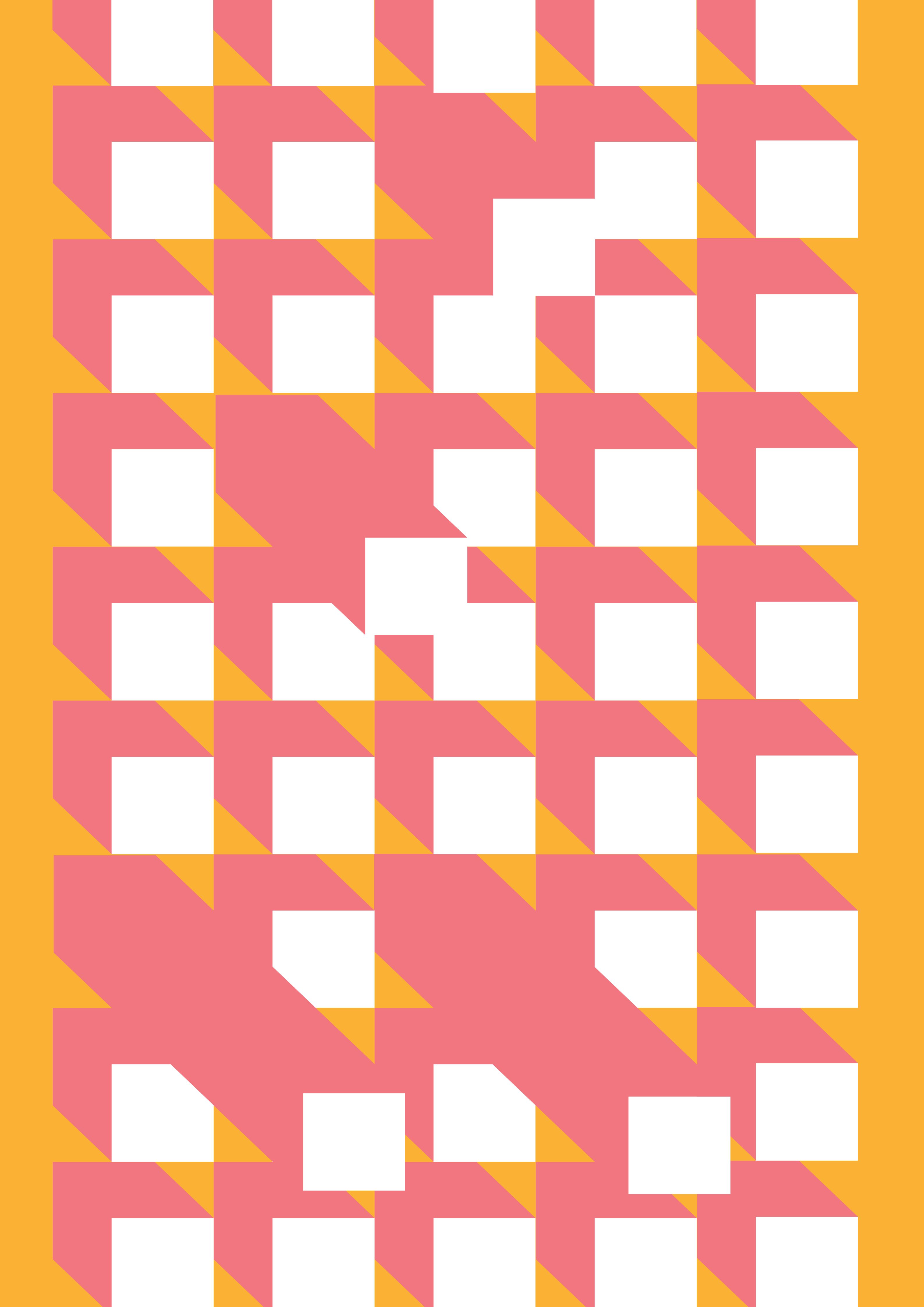


Table of contents

Important message

This report ("the Report") has been prepared by Advokatfirmaet PricewaterhouseCoopers AS for the Mediebedriftenes Landsforening (Norway), Danske Medier (Denmark), Finnmedia (Finland) and TU-Medier (Sweden) in accordance with the contract dated 7 April 2017, Supplementary Agreement dated 28 August 2018 (together "the Contract") and on the basis of the terms, scope and limitations set out in the Contract.

The Report is provided exclusively for these organisations' use under the terms of the Contract. The Report can however, be freely disclosed, but may not be relied upon for any purpose by third parties, to whom we owe no duty of care. We therefore, disclaim all liabilities and responsibilities arising from any reliance upon this Report by third parties.

This Report provides a summary of the work carried out by the OECD/G20 and the EU since May 2017. As such, this Report mainly address the OECD 2018 Interim Report and the EC Digital Tax Package published in March 2018, including the two proposals for Council Directives laying down rules relating to the corporate taxation of significant digital presences and on the common system of a digital service tax on revenues from the provision of certain digital services.

We have not made any assessments and express no opinions in relation to the tax affairs of any countries, companies, entities, organizations or persons. Any information obtained by third party reports, news articles or any other sources of information has not been subject to any review or verification by PwC. Accordingly, we express no opinion on the reliability, accuracy or completeness of the information provided and upon we have relied. The foreword has been made by the Nordic media organisations and as such is not part of the PwC Report.

Further, the purpose of this Report is to provide an objective status update of the work carried out by the OECD/G20 and the EU since our previous report was issued in May 2017, and not to conclude on what is the preferred political solution. Any considerations, arguments and conclusions on technical matters presented in this Report does not necessarily represent the official view of PwC.

We reserve the right, but will be under no obligation, to review or amend our Report, if any additional information, which was in existence on the date of this Report was not brought to our attention, or subsequently comes to light. This final Report was issued on 12 November 2018.

Best wishes,
Advokatfirmaet PricewaterhouseCoopers AS

Ståle Wangen
Partner/Head of International Tax

Kim Fosshaug
Director/Attorney

1

Executive summary

Main output

Our previous report on “Unequal taxation in a digital world - a challenge for the Nordic media industry” (“2017 Report”) - was published in May 2017. The 2017 Report outlined in detail the current tax framework, the hallmarks of digitized business models compared to more traditional business models, the development in digital technology and its impact on the economy, and the challenges resulting from the current tax framework’s failure to capture digitized business models. Specifically, we pinpointed that the current tax framework’s failure to capture digitized businesses lead to a common perception that the taxation system was unfair and that taxing rights were allocated mostly to the advantage of multinational players. Furthermore, based on the different actions published by OECD under the BEPS project, respectively Action 1 addressing the digital economy, the 2017 Report outlined the work carried out by the OECD and others up until May 2017.

Our conclusion, based on the available sources at the time, the development in the media market and the lack of global consensus to coordinated solutions, was that the situation for the Nordic media industry is destructive. Hence, we recommended that domestic measures should be considered and possibly introduced in order to ensure competition on more equal terms between the global and Nordic media players. To support our conclusion, we added that taking domestic measures would most likely also increase the general sense of justice and help preserve social fairness.

Since our 2017 Report was published, progress on finding solutions to the incremental taxation issues in the field of the digital economy has been both at the OECD/G20 and the EU level. Simultaneously, an increasing amount of Member States have taken matters in their own hands by introducing, or planning to introduce, uncoordinated unilateral measures.

This report mainly provides a review of the work carried out by the OECD and the EU since May 2017, and the two solutions proposed by the European Commission (“the EC” or “the Commission”). After having reviewed the propositions and the different arguments presented by IF members, EU Member States and others, the main outputs from this report are that measures should be taken in order to ensure fair taxation and a level playing field. Further work is, however, required to better understand how value is created in digitized business models, the accuracy of the propositions rendered by the Commission and for a consensus to be reached at the OECD and/or EU level.

Reviewing the available options presented by the Commission and the pro and contra arguments presented by Member States and others, we believe a global (comprehensive) solution is preferable in order to achieve fair taxation in the digital world. We believe fair and clear tax practices on digital services can be achieved only by amending tax treaties to reflect the changes currently happening in the digital economy. A more detailed assessment on value creation is, however, needed to ascertain where value is in fact created, so as to achieve the aim of fair taxation practices.

Despite opposing arguments and concerns, we also believe the DST may function as a suitable interim solution. This presupposes, however, that the DST is replaced by a comprehensive solution at a later point and thus only acts as a temporary solution, and, preferably, is implemented as a coordinated measure at the EU level. Further, the idea that the DST may function as a suitable interim solution presupposes that further assessments of the interim and comprehensive solution are made, and that consensus on a comprehensive solution cannot be reached within a reasonable amount of time. Should the EU not, within a reasonable time period, be able to reach the required unanimous vote for introducing the DST, the Nordic countries should consider acting unilaterally by introducing the DST as an interim solution themselves. This could temporarily level the playing field for the Nordic media players.

High level summary of the work carried out by the OECD/G20 and the Commission

OECD/G20

At OECD/G20 level, the work has thus far resulted in the report Tax Challenges Arising from Digitalisation - Interim Report 2018, published in March 2018 (“OECD 2018 Report”). In the report, the OECD stresses the importance of the BEPS project and that tax planning strategies are being addressed through the implementation of different BEPS actions. At the same time, the OECD admits that there is growing evidence that tax planning strategies are changing and that challenges raised in the BEPS Action 1 report have not been properly addressed. Nor has other BEPS actions that partly target digitized business models (actions re PE threshold) thus far had a sufficient effect as many Member States has not opted for these actions.

The OECD 2018 Report is an interim report and does, as such, not provide any final suggestions or solutions. Instead, the report mainly explores the challenges of the digital economy, along with, to a certain extent, acknowledging that other factors, such as how to deal with sharing economies, the business tax functions, financial data, the people and systems, and the impact of technology on tax administrations, need further attention.

Further, the OECD 2018 Report also shows that while Inclusive Framework ("IF") Members seem to agree on what the prominent features of digital business models and root-cause of the challenges are, there is no consensus on their relevance and importance to the question of where value creation is located.The different views asserted by IF

Members can be divided into the following three groups:[1]

- one group maintains that there is no need for any major change,
- a second group recognises a need for certain changes to the international tax framework to reflect the impact of digitalisation on business models and value creation and,
- a third group believes that fundamental change is required to reflect globalisation at large.

The OECD 2018 Report acknowledges these different viewpoints and does not argue in favour of or against any of the different viewpoints. Nor does the OECD 2018 Report state any discontent towards countries that believe there is a strong and imperative need to act quickly, and that consequently have introduced, or are considering to introduce, uncoordinated unilateral measures.[2] The OECD 2018 Report does, of course, support coordinated measures, and outlines a number of risks that should be taken into consideration by IF members considering imposing unilateral measures.

Although the OECD 2018 Report does not present any final solutions or propositions, the 2018 Report is conceived as suggesting that focus should be on the *comprehensive solution*, i.e. introducing new permanent establishment rules that also capture businesses with a "digital presence" and updating the principle for attribution of profit that takes into account the contribution of users to the value creation process. Specific options are, however, not mentioned.

The final outcome of the OECD/G20 work is all but certain. The OECD is, however, committed to spending the next two years looking for ways to bring the IF Members closer together on a compromise. As part of the next phase of their work, the OECD and the Inclusive Framework member states have agreed to undertake a coherent and concurrent review of the "nexus" and "profit allocation" rules - fundamental concepts relating, respectively, to the allocation of taxing rights between jurisdictions and the determination of the relevant share of multinational enterprises' profits subjected to taxation in a given jurisdiction. In exploring potential changes, the impacts of digitalisation on the economy, relating to the principles of aligning profits with underlying economic activities and value creation, will be considered. A progress update will be provided in 2019, and the final report is scheduled to be published in 2020.

EU:

At EU level, the work has resulted in the Commission's release of a *digital tax package* on March 21 2018. The digital tax package consists of a (non binding) Communication to the European Parliament and the Council of the EU, both providing background information and an explanation as to why the EC considers the digital economy to be undertaxed. The digital package culminates in two formal drafts: the Proposal for a Council Directive, which lays down rules relating to the corporate taxation of significant digital presences, and the Proposal for a Council Directive, which is on the common system of a digital service tax on revenues from the provision of certain digital services.

1 PwC Tax Policy Bulletin of 9 April 2018 on "OECD and EC release disparate recommendations on tax and the digitalisation of the economy

2 See p 26 et seq. of our 2017 Report and Chapter 6 of this Report for a summary of select unilateral measures

Similar to the OECD 2018 report, the EC digital tax package provides a broad background description and problem definition, presenting the background for today's challenges and the hallmarks of digital business models compared to more conventional business models.

Contrary to the OECD, the EC digital tax package contains proposals for two solutions: a comprehensive solution and an interim solution.

Comprehensive solution
The comprehensive solution proposes, in short, changes to the definition of permanent establishments and principles for how profits should be allocated. The proposal is comparable to what is indicated as the preferred solution by the OECD.

The proposed Directive lays down rules for establishing a taxable nexus for cases where there is a non-physical commercial presence of a digital business ("significant digital presence"). According to the proposed Directive, a digital platform constitutes a significant digital presence if one or more of the following criteria are met:

> the proportion of total revenues obtained in that tax period resulting from the supply of those digital services to users located in that Member State in that tax period exceeds EUR 7,000,000;
> the number of users of one or more of those digital services located in that Member State in that tax period exceeds 100,000;
> the number of business contracts for the supply of any such digital service concluded in that tax period by users located in that Member State exceeds 3,000.

The proposed Directive also sets out the principles for attributing profits to the significant digital presence. According to the proposed Directive, a functional analysis should be carried out. The economically significant activities performed by the significant digital presence through a digital platform, include, i.a., the following activities:

> the collection, storage, processing, analysis, deployment and sale of user-level data;
> the collection, storage, processing and display of user-generated content; (c) the sale of online advertising space;
> the making available of third-party created content on a digital marketplace;
> the supply of any digital service not listed in points (a) to (d).

On attribution of profit, the proposed Directive recommends that the profit split method is the default method in determining the attributable profits. Exceptions may apply to taxpayers able to demonstrate that there is an alternative method more appropriate in light of the results of the functional analysis.

According to the proposed Directive, the rules shall apply to all taxpayers subject to corporate tax in one or more Member States. The rules shall also apply to entities resident for tax purposes in a third country, in respect of their significant digital presence in a Member State.

The proposed Directive also lays down rules for when the Directive shall not apply: It shall not apply if an entity is resident for tax purposes in a non-EU jurisdiction that has a double tax treaty (DTT) in force with the Member State in which there is a significant digital presence unless i) that DTT includes similar provisions on a significant digital presence and the attribution of profits thereto to those of the draft Directive, and ii) those provisions are in force.

The EC proposes that the Directive should apply per 1 January 2020.

Interim Solution

The second proposed Directive entails introducing a short term digital sales tax ("DST") at the EU level. In explaining the need for an interim, as well as a comprehensive, solution, the EC draws on current developments in the EU Member States, which, specifically, include that Member States increasingly are taking uncoordinated unilateral measures. Considering, additionally, that implementing the comprehensive solution itself will take time, as it requires re-negotiating treaties, an interim solution seems pressing.

According to the proposed Directive, the tax rate shall be 3% on gross revenue (net of VAT and similar taxes) derived in the EU on the following services:[3]

> Advertising placed on a digital interface targeted at users of that interface;
> the making available to users of a multi-sided digital interface which allows users to find other users and to interact with them, and which may also facilitate the provision of underlying supplies of goods or services directly between users;
> the transmission of data collected about users and generated from users' activities on digital interfaces.

Exemptions do, however, apply to revenues resulting from the provision of any of the said services by an entity belonging to a consolidated group for financial accounting purposes to another entity in that same group. Moreover, if an entity belonging to a consolidated group for financial accounting purposes provides a service mentioned above and the revenues resulting from the provision of that service are obtained by another entity in the group, those revenues shall be deemed to have been obtained by the entity providing the service.

Furthermore, the DST applies to entities producing both a total annual revenue above EUR 750 million and total annual taxable digital revenues in the EU above EUR 50 million. Thus, in effect, SMEs and micro entities should be excluded from the scope of the DST.

With respect to the place of taxation of the DST, the proposed Directive suggests that the DST is levied based on the location of the users of the taxable service. A simplification mechanism in the form of a One-Stop-Shop is proposed established for taxable persons with DST liability in one or more Member States. According to the EC, it is also expected that Member States will allow businesses to deduct the DST paid as a cost from the corporate income tax

3 See Commission Recommendation of 21 March 2018 p. 53 et seq., PwC Tax Policy Bulletin 9 April 2018, PwC EU Direct Tax Newsalert 21 March 2018

base in their territory, in order to mitigate possible cases of double taxation where the same revenues are subject to corporate income tax and DST.

Finally, note that the Committee on Economic and Monetary Affairs ("ECOFIN") released a draft report on 21 September 2018 in which the ECOFIN provides comments to the EC proposed Directives. In the draft report, ECOFIN proposes, in short, to increase the DST tax rate from 3% to 5% and to broaden the DST tax base by including the supply of digital content such as video, audio or text and the sale of goods or services contracted online via e-commerce platforms. ECOFIN also requests the European Commission to issue guidelines on how a significant digital presence and digital services are to be identified, measured and taxed.

Next steps

The EC's proposals are sent to the Council and the European Parliament and are currently under review and debate. To adopt the proposals, the Council must, pursuant to consultation in the European Parliament and the Economic and Social Committee, confirm the proposals by a unanimous vote. The powerful ECOFIN committee is scheduled to consider the tabled amendments to the proposed Directives in its meeting on the 19 November 2018, and to vote in the ECON Committee on 3 December 2018. A final vote on both draft Directives is expected in the EU Parliament's Plenary Session on 17 January 2019. Due to the upcoming EU Parliament election in 2019, some EU legal scholars however assume that the DST may be further delayed if consensus is not reached before the end of 2018.

As envisaged, an abundance of discussions are ongoing between not only Member States, but also third countries, entities and organisations. Considering the current, prevailing climate, it can safely be assumed that it is highly uncertain whether a unanimous vote will or can be achieved. What is quite certain, is that the proposed Directives are a long way from being agreed on. For a summary of select arguments presented by Member States and others, we refer to chapter 6 of this report.

2

Introduction and way forward

Our previous report on Unequal taxation in a digital world - a challenge for the Nordic media industry ("2017 Report")- was published in May 2017. The 2017 Report provided a detailed description of the current tax framework, the hallmarks of digitized business models compared to more traditional business models, the development in digital technology and its impact on the economy, and the challenges resulting from the current tax framework's failure to capture digitized business models leading to what is broadly conceived as an unfair taxation and allocation of taxing rights to the advantage of multinational players. Furthermore, the 2017 Report outlined the work carried out by the OECD and others up until May 2017, the main legal sources of information being the different actions published by OECD under the BEPS project, respectively Action 1 addressing the digital economy.

We have now been asked to provide a summary and review of the work carried out by the OECD/G20 and the EU since May 2017. As such, this report will mainly address the OECD 2018 Report and the EC Digital Tax Package published in March 2018.

We will also address the ECOFIN draft report published in September 2018 and provide an update to the different uncoordinated domestic measures taken by countries in the wait for solutions to be proposed by the OECD or resolved by the EU. This Report also includes a high level review and discussion on the way forward in the OECD and the EU and a high level discussion on whether or not the proposed EU measures are equipped to reach their goals and likely to be introduced, including a high level discussion on whether or not the Nordic countries should consider introducing domestic (interim) measures.

Hence, we will not outline in detail the core issues of the challenges that are currently debated in the OECD and the EU but refer to our 2017 Report for further details. However, in order provide context and to ease the read of this report, you will find below a high level summary of the background and problem definitions provided by the OECD and the EC in the OECD 2018 Report and the EC digital tax packaged (mainly the EC Recommendation of 21.3.2018 relating to the corporate taxation of a significant digital presence).

As agreed, the scope of this Report is furthemore limited to select corporate tax issues, i.e. we will not address the ongoing work connected to VAT in the EU or VAT related issues. Nor will challenges in relation to the application of personal income taxes be addressed. Finally, we will not address statistics, etc. but refer to our 2017 Report for the different statistics and figures showing the Nordic total advertising market revenues, expected outlook for the media industry and distribution of revenues between the media players (nordic vs. global), etc. To our knowledge the trending outlook remains the same.

3

Background and problem definition

Industrial economy and the digital economy - common challenges due to the globalization of the economy

Both the OECD 2018 Report and the EU digital tax package (respectively the EC Recommendation) address challenges resulting from the globalization and digitalization of the economy, and outline what the possible causes of these challenges may be. While the EC addresses both global issues and EU specific challenges, the OECD's main focus is the global economy and the actions following the BEPS project.

The globalised economy poses a number of challenges to the established international tax framework: Modern communication and liberalisation of trade policy have allowed for easier (or free) flow of capital and labour, as well as the relocation of production facilities; multinational enterprises have grown to represent a large portion of the global GDP, and operating models have shifted from being country-specific to being global, allowing for an increased shifting of profits to low or no-tax jurisdictions.

Further, data collection is doubling every year. Combined with advances in data analytics and technology diffusion, this provides the insight necessary to transform and shape the way people and organisations behave and operate, respectively.

Existing tax rules are built on the principle that profits should be taxed where value is created. These rules were, however, mainly conceived in the early 20th century for traditional «brick and mortar» businesses, leading to rules that determine a country's taxing rights based on whether the business in question has a physical presence in that country. Consequently, non-tax residents were only liable to tax in a country provided their presence in that country amounted to a permanent establishment.

The current framework fails to capture the global reach of digital business models, which primarily rely on intangible assets, data and knowledge, and conduct activities remotely without any physical presence. The difference in how digital business models are operated and structured has lead to a disintermediation process - also referred to as "scale without mass" business structures. As a result, businesses of the digital economy have a fundamentally different international footprint,[4] with far fewer assets in the location of their foreign sales.[5]

Thus, the current definition of permanent establishments and principles for profit attribution fail to encompass cross border digital business models, leading to a misalignment of the place where value is created, notably in the case of user contributions, and the allocation of taxing rights and ability to enforce taxation.[6]

According to the EC, companies with digital business models pay as a result less than half the tax rate of businesses with traditional business models: In the EU, the effective average tax rate of digital business models are 9.5% compared to 23.2% for traditional business models.[7] [8] According to the EC, this is partly due to the outdated tax system, built- in incentives by governments for digital companies, and in some cases due to aggressive tax planning. For an example on how digital models may be structured and how a specifically chosen structure may lead to misalignment between taxing rights and value creation, please refer to page 17 et seq. in our 2017 Report.

Through the BEPS actions, the OECD addresses these larger issues from a global perspective in a

4 International footprint = (foreign sales/total sales)(foreign assets/total assets), EC Recommendation p. 12

5 https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_common_system_digital_services_tax_21032018_en.pdf

6 See caper 2 of the EC Recommendation

7 See chapter 2 of the EC Recommendation and 2.1 in the Communication from the EC.

8 Note that the EC's calculations has been challenged, e.g. by the Copenhagen Economics in their report of September 2018 on "the proposed EU digital services tax: Effects on welfare, growth and revenues". In the report the EC argues that the difference in effective tax rates are not that vast but in fact close to comparable. Should this be the case, one could argue that introducing measures to tax the digital economy is not about levelling the playing field, but rather a political discussion and measures on how to achieve what is perceived as a more fair allocation of taxing rights.

number of specific areas. As shown below under the review of the BEPS 2018 Interim Report, Action 7 amends key provisions of the permanent establishment article in the Model Tax Convention. Under the new provisions, local subsidiaries that perform support functions, such as, supporting and facilitating sales on a cost plus basis, may be considered a permanent establishment. Furthermore, exceptions for certain functions like storage and delivery of goods are restricted. As such, businesses like online stores, where storage constitutes a core part of the business model, may be considered to have a permanent establishment.

However, considering the somewhat small percentage of tax treaties that are amended thus far, it could be argued that the BEPS package itself is not sufficient to bring forth fair taxation in the digital world. In any case, the OECD has seen the need for further assessments of the digital economy and the challenges arising from the mismatch between how the current tax framework is shaped and how modern digitized business models operate. Such further assessments are provided in the OECD 2018 Report.

Similar to the OECD, the EC is of the opinion that the solution must ultimately be a global solution as the issue is global and "there is a need to better harness globalisation with proper global governance and global rules"[9]. Hence, the EC works closely with the OECD in order to support the development of a global comprehensive solution.

In addition to global concerns shared by the OECD and the EU, the EC Digital Tax Package focuses on the EU and the functionality of the single market. As an agreement on solutions are not expected any time soon, causing challenges at the international level, the EC sees a strong need for quick and coordinated

9 Communication from the Commission to the European Parliament and the Council p. 5.

single set of corporate tax rules across the EU.[11]

Furthermore, the EC argues that coordinated interim actions are required while waiting for a comprehensive solution in order to mitigate the risk of interim unilateral actions either adopted, or planning to be adopted, by Member States. Such uncoordinated, unilateral measures, may create an increased risk of fragmentation of the Single Market and distortions of competition within the EU.[12]

The EC also argues, in short, that an "EU action would be more efficient and would minimize compliance cost" and that an EU action "would help steer the discussions at international level on the taxation of the digital economy in a more effective way than action at Member State level." [13]

action at the EU level. According to the EC, only a common and coordinated EU action may tackle the existing problems as "the problems posed by the current tax framework are not particular to any specific Member State but constitute a common challenge for the EU as a whole."[10]

If coordinated actions are not taken as soon as possible, the EC sees a clear risk that further unilateral actions will be taken by Member States. In respect to the comprehensive solution, the EC argues that uncoordinated and unilateral actions may undermine the existing work at EU level on the wider corporate tax rules: only a coordinated action would be coherent with the efforts already made to subject taxpayers to a

10 Commission Recommendation p. 20
11 Currently, the corporate tax framework is only to a limited extent harmonised at EU level. The EC has however adopted relevant proposals (CCTB and CCCTB) that aims at increased harmonization by subjecting tax payers to a single rulebook of corporate tax legislation.
12 Commission Recommendation p. 21.
13 Commission Recommendation p. 21.

4

OECD/G20 Base Erosion and Profit Shifting Project: Tax Challenges Arising from Digitalisation - Interim Report 2018

4.1 Introduction: tax and the global environment

4.1.1 The BEPS-project and actions taken to mitigate traditional tax planning within traditional sectors (PE-clause and Amazon, use of intermediaries) - a backdrop to why further actions are deemed required

As outlined in our 2017 Report, the BEPS Project, initiated in 2012, reinforced the international tax framework to avoid base erosion and profit shifting from jurisdictions where economic value is created to low-tax jurisdictions. The project resulted in a final report in 2015, containing 15 action points to address the issue. In the years following the report, over 110 jurisdictions implemented coordinated changes to tax treaties through a multilateral instrument ("MLI"), as well as changes to domestic tax law.

The BEPS project was built around three main pillars: reinforcing the coherence of corporate income tax rules at the international level, realigning taxation with the substance of the economic activities and improving transparency.

The action plan consists of 12 actions targeting different tax planning practices including, inter alia, hybrid mismatches, thin capitalisation, treaty shopping, artificial avoidance of permanent establishment status and transfer pricing. A few measures amount only to minimum standards, mandatory to all participating jurisdictions; however, most measures are either optional standards or common approaches and best practices (soft law).

Action 1 of the BEPS Action Plan calls for work to address the tax challenges of the digital economy.

In BEPS Action 1, the OECD concluded that it is impossible to ring-fence the digital economy from the rest of the economy, as it increasingly is becoming the economy itself. Therefore, the OECD seeks to address the relevant BEPS issues in the digital economy by applying a combination of:

- Action 3 (strengthening CFC rules),
- Action 7 (preventing the artificial avoidance of permanent establishment status) and
- Actions 8-10 (assuring that transfer pricing outcomes are in line with value creation)

were expected to tackle some of the tax issues related to the digital economy.

By widening the PE definition for dependent agents and an update of the specific activity exemptions in OECD Model Article 5 (4), BEPS Action 7 was, in particular, thought to prevent the artificial avoidance of PE status for digital global players.

Currently, a PE is triggered when an agent acting on behalf of a foreign enterprise habitually exercises authority to conclude contracts in the name of the enterprise, unless the agent is an independent agent acting in the ordinary course of its business. Since the current definition is limited to the formal conclusion of contracts, the OECD widened it to also include situations in which an agent habitually plays the principal role leading to the conclusion of contracts that are then routinely concluded without material modification by the enterprise.

Action 7 also recommended an update of the specific activity exemptions found in Article 5 (4) of the OECD Model, according to which a PE is deemed not to exist where a place of business is used solely for activities listed in that paragraph (e.g., the use of facilities solely for the purpose of storage, display or delivery of goods, or for collecting information). The proposed amendment prevents the automatic application of these exemptions by restricting their application to activities of a "preparatory or auxiliary" character.

This change is particularly relevant for some digitalised activities, such as those involved in business-to-consumer (B2C) online transactions, and certain local warehousing activities, which were where previously considered to be merely preparatory or auxiliary in nature. The latter may now, pursuant to the change, be considered core business activities. Under the revised language of Article 5 (4), these types of local warehousing activities carried out by a non-resident no longer benefit from the specific activity exemptions usually found in the PE definition provided they are not preparatory and auxiliary in nature. An example of a business now falling outside the scope of the amended rules of exemption, is a large warehouse maintained by a non-resident enterprise in a market jurisdiction in which a significant number of employees work for the main purpose of storing and delivering goods owned and sold by the non-resident enterprise. The warehouse must additionally constitute an essential part of the non-resident enterprise's sales/distribution business.[14]

However, based on the positions taken by countries so far, the revised definition of a dependent agent would only apply to approximately 17% of the 1 246 tax agreements currently covered by the MLI (i.e., approximately 206 bilateral tax agreements).[15]

For the revised provision defining specific-activity exemptions (Article 5 (4) of the OECD Model estimated that, based on the positions taken so far, this revised provision applies to only around 22% (i.e., approximately 277 bilateral tax agreements).[16]

- *Considering the somewhat small percentage of tax treaties amended , it could be argued that the BEPS package itself is not sufficient to achieve fair taxation in the digital world. Hence, further work has been required (requested? Or "is" required) at the OECD level in order to assess the challenges resulting from the digitized economy, and to establish what possible solutions to these challenges should be.*

4.2 High level review of mandate, scope and purpose of the OECD 2018 Interim Report: a closer look at challenges arising in the era of digitalization.

In 2017, the IF extended the mandate of the Task Force on the Digital Economy (TFDE) to include an interim report on the digital economy in 2018 and a final report in 2020. In preparing for the interim report, stakeholders were requested to give their input in 2017. The task force received more than 50 submissions, and these were elaborated on in a public consultation in November 2017.

To provide a background to the taxing challenges posed by the digital economy, the interim report provides an in-depth analysis of how value is created in various types of digitalised business models. The initial analysis provided grounds for identifying three characteristics prevalent in more highly digitalized businesses: cross-jurisdictional scale without mass;

14 https://www.oecd-ilibrary.org/docserver/9789264293083-en.pdf?expires=1539876210&id=id&accname=guest&checksum=FEC746D705A815B7EBA609BEA01E3E4C
15 Ibid
16 Ibid

reliance on intangible assets, including UP; and data, user participation and their synergies with IP.

Different opinions persist between the participating jurisdictions on how these characteristics should shape and impact allocation of value creation for tax purposes. In particular, there is no consensus on whether user contribution contributes to value creation and thus should determine whether a specific country in any given case holds the taxing rights..

The report continues on to identify three concepts of value creation:

value chain - inbound logistics, operations, outbound logistics, marketing and sales, service.
value network - network promotion and contract management, service provisioning, and infrastructure operation.
value shop - problem finding, problem solving, choices, and execution, control/ evaluation.

All of the values above may take place in highly digitalized businesses. However, no conclusions are drawn with respect to where value creation in general and specific business models takes place.

The OECD Report's explanation of digital marketplaces, including value creation, is broad and thorough. This may indicate that the OECD does not rule out potentially targeting any new or revised tax measures.

The report further reviews the progress of implementation of the BEPS package, specifically with respect to actions relevant to the digital economy, and the domestic measures taken by countries to address some of the broader tax challenges in the digital economy not addressed in the BEPS action. The report finds it likely that jurisdictions will continue to implement unilateral measures to address issues pertaining to the digital economy until a global consensus is reached.

4.3 Differences that necessitate other actions and measures to be taken to ensure a fair taxation of the digital economy

The OECD report emphasises that the implemented BEPS actions and measures may not be effective in solving the broader tax challenges in the digital economy. The reason is that many of the rules on taxation of cross-border activities were created and enacted in a time where such activities relied on tangible assets and intensive use of labour.[17]

The report identifies two sets of underlying rules that shape the framework of international tax. Firstly, the "nexus rule" determines which jurisdiction holds the right to tax non-resident entities. Secondly, profit allocation rules, based on the arm's length principle, determine the allocation of taxing rights between involved jurisdictions. Both these sets of rules are dependent on the requirement of physical presence, and are thus not necessarily suitable for application to business models adopted in the digital economy.

Where amendments to the permanent establishment provisions are meant to ensure nexus in cross-border sales models, the supply of digital products and services would not have a taxable presence as no physical presence is required. With respect to determining nexus and allocating profits the report identifies three (overlapping) categories of challenges with the digital economy: nexus, data and characterisation.[18]

Nexus: Digital technology and the increasing role of network effects reduce the need for physical presence to carry out business, thus reducing the effectiveness of existing nexus rules.
Data: The increase in cross-border information use and gathering pose challenges in the allocation of

17 https://www.oecd-ilibrary.org/docserver/9789264293083-en.pdf?expires=1539866967&id=id&accname=guest&checksum=E6E0D46878B4D9077D8D115B68DDA943
18 Ibid p. 169

value creation in products and services that are based on this data. The supply of (free) information from participation networks pose challenges in regard to whether this is characterised as a transaction for tax purposes.
Characterisation: The characterisation of payments in connection with new digital products and means of delivery systems pose challenges and uncertainty.

In summary, challenges to the taxation of the digital economy can be attributed to several factors. Firstly, there are a plethora of ways to plan around international taxation rules, due in part to relatively large gaps in the current international taxation law system. Secondly, new business models have emerged to adopt to the digital economy, leading to new ways to create value. Thirdly, businesses no longer rely on having a physical presence in the country they operate in. To achieve a common solution to these challenges, jurisdictions must also agree on a common understanding of where and how value creation happens and should be allocated.

At this stage, the OECD Report does not specifically outline options for designing a digital or virtual permanent establishment (PE). The threshold that must be met to trigger a PE and the factors that should go into considering how to allocate profits from the PE, will be a key concern for the stakeholders.

4.4 Review of the different solutions presented by the OECD/G20 in the Interim Report: interim measures, long term measures, nexus, legal challenges due to sovereignty, tax treaties and procedures for incorporation, etc.

The 2015 final report on the digital economy concluded that it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy.[19] The interim report builds on this conclusion, but recognises that the 2015 BEPS package may not adequately address tax issues related to nexus, data and characterisation.

A number of jurisdictions have implemented or are considering to implement interim measures to address these challenges in the wait for a consensus-based common solution. However, these jurisdictions recog-

19 https://www.oecd-ilibrary.org/docserver/9789264241046-en.pdf?expires=1539872912&id=id&accname=guest&checksum=497664CE86D28344A34DD828B3518B46 p. 11

nise the potential adverse effect of having a variety of different domestic interim measures. Therefore, it has been requested that a set of common guiding principles be published to minimise the differences between unilateral measures.

The report concludes that the issues raised by the digital economy are highly complex and technical questions, warranting continued monitoring towards the final Report in 20200. Moreover, further work is required to reach a consensus on the question of whether features of highly digitalized business models and digitalization should lead to changes in international tax law. As such, the report does not render any final proposal in respect of the issues considered in the report. The report does, however, set out general guidelines for taxing digital businesses as well an analysis of potentially adverse effects of doing such, in attempt to coordinate the unilateral actions either taken, or about to be taken, by various states.

The analysis of potential adverse effects lists the following:

- Impact on investment, innovation and growth,
- Impact on welfare (i.e. distortion of input and output in businesses),
- Potential economic incidence of taxation on customers and businesses,
- Possibility of over-taxation,
- Possible difficulties in implementing a tax as an interim measure, and
- Compliance and administrations costs.

To mitigate the potential adverse effects of interim measures, the following guidelines are provided:

> Compliance with international obligations: Compliance with obligations that flow from regional political and economic groupings like the EU and the EEA, as well as membership in organisations like the World Trade Organization should be closely considered.

- Temporariness: An interim measure should recognise the policy intent of it being temporary. It should cease to apply once a global response have been agreed on and implemented. A unilateral interim measure should not reduce the commitment to a coordinated global agreement.

- Targeting: To mitigate the potential distortion to businesses' input and output and effect on start-ups and small businesses as well as other adverse effects, an interim measure should be as limited in scope as possible. Specific issues are raised in regard to taxing internet advertisement.

- Minimising over-taxation: The report concludes that both the rate and scope of an interim tax should be limited to mitigate the risk of over-taxation. Specific regard must be taken to the profit margins in the businesses it applies to and registration-thresholds should be considered. In regard to taxes based on revenue (gross-taxes), the avoidance of cascading problems may result in additional administration and compliance costs. A tax similar to VAT are discouraged due to undue complications to the design of the tax, given the temporary nature of such a tax.

- Minimising impact on start-ups, business creation and small businesses more generally: The issues raised under targeting and minimising over-taxation are highly relevant in shielding vulnerable businesses from adverse consequences of interim measures. In regard to a tax on turnover, it is recommended that a gross threshold based on the company group as a whole is considered. It is further suggested that this is combined with local sales threshold to shield businesses with a low level of supplies of e-services in a particular jurisdiction, where the cost of administration and compliance would not be justifiable.

> Minimising cost and complexity: On a general basis, it is recommended that compliance cost for taxpayers and tax authorities is a key consideration. Given the temporariness of the measure, this is especially true. The report emphasise the need for a common 'place of supply' rule which determine whether a supply of an e-service has been made within the taxing jurisdiction. [20]

4.5 Why the OECD/G20 did not render a final proposition and what the next steps are(follow-up report in 2020).

Although there seems to be an increasing consensus that actions must be taken, there is still no consensus on the need for measures targeting tax issues specifically pertaining to the digital economy, nor to how such actions should be designed . The OECD 2018 Interim Report identifies three groups of countries:

- one group that maintains that there is no need for any major change,
- a second group that recognises a need for certain changes to the international tax framework to reflect the impact of digitalisation on business models and value creation and,
- a third group that believes that fundamental change is required to reflect globalisation at large.

The members of the Inclusive Framework acknowledge the dissenting opinions on the matter. However, there is agreement that they share a common interest in maintaining a single set of rules to promote economic efficiency and global welfare.

While IF members agree on the principal features of digital business models, there is no consensus on their relevance and importance to the location of value creation and the identity of the value.

In preparing for the final report scheduled to be completed in 2020, the task force will continue to analyze how prevalent characteristics of highly digitalized businesses affect how these businesses create value. Furthermore, the work towards the 2020 report will include exploring technical solutions to test the feasibility of alternative options regarding nexus and profit allocation, gathering input from a broader group of stakeholders and continuing to monitor the effects of the unilateral measures implemented by participants. The task force will release an update - interim report - on the work in 2019.

The task force will release its final proposal to address tax issues related to the digital economy, aiming to bridge the differences between members and achieve a common solution.

20 https://www.oecd-ilibrary.org/docserver/9789264241046-en.pdf?expires=1539872912&id=id&accname=guest&checksum=497664CE86D28344A34DD828B3518B46

5

The EC Digital Tax package

5.1 Introduction

On 21 March 2018, the EC released its digital tax package. Along with explaining why the EC considers the digital economy to be undertaxed, the digital tax package also comprises two formal draft directives: the proposal for a Council Directive, which lays down rules for corporate taxation of significant digital presences, and the proposal for a Council Directive, which regards the common system of a digital service tax on revenues from the provision of certain digital services. Additionally, a recommendation on corporate taxation is made.

In the EC Recommendation, the EC gives a broad and detailed outline and review of the background to the issues by providing a problem definition and a review of the root causes (chapters 1-2). Furthermore, the EC presents arguments for why the EU should act and establishes what the proposals aim to achieve (chapters 3-4), along with providing broad assessments of the available options for the comprehensive and interim solutions, the impacts of the respective solutions and reviews of the preferred comprehensive and interim solutions as put forward in the two proposals for council directives (chapters 5-9).

For a high level review of the root cause as explained and outlined by the EC in the Recommendation, including the specific arguments as to why the EC should act and the arguments for introducing both a comprehensive and interim solution (EC Recommendation chapters 1-4), reference is made to Chapter 3 of this report and to our 2017 Report.

In the following, the focus will be on what the EC considers to be available comprehensive and interim solutions, as well as the reviews of the preferred comprehensive and interim solutions (Chapter 5-9 in the EC Recommendation) as presented in the two draft Directives.

5.2 Objectives: What is to be achieved?

The presented initiative encompasses an interim, as well as comprehensive, solution. The EU Commission sets out general and specific objectives for both solutions. *General objectives* for both the interim and comprehensive solution include protecting the integrity of the single market by ensuring its proper functioning; making sure that public finances of Member States/ the EU are sustainable and that national tax bases are not eroded; ensuring that social fairness is preserved by creating a more efficient taxation framework that properly captures value creation, and outlining how to fight aggressive tax planning.

What the *specific objectives* are, depend on whether the interim or the comprehensive solution is in focus. The specific objective for the *comprehensive solution* is to create “a modern corporate tax framework which allows for the fair and efficient taxation of the digital economy”.[21] As the current rules were adopted in the 19th century, a period of time unfamiliar with the con-

21 COMMISSION STAFF WORKING DOCUMENT, IMPACT ASSESSMENT, Accompanying the document, Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence and Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, 2018, pg. 23.

cept of digital economy, the main idea is to update the rules and create a framework that better reflects the new digital era that has emerged. For the *interim solution*, the specific objective is "to put forward measures that would target certain digital activities as a proxy for the comprehensive solution"[22] and to avoid uncoordinated unilateral actions taken by Member States. Compared to the comprehensive solution, the interim solution should, in the opinion of the EC, be easier to implement and level the playing field until a long term solution is in place. [23]

5.3 What are the available comprehensive policy options

5.3.1 What is the baseline against which options are assessed?

In its impact assessment, the EU Commission outlines available comprehensive policy options. Before outlining the available options, the EC outlines the background of the proposal, which, in short, is the significant benefits that digital transformation brings to society, and consequently, the taxation issues that arise. Moreover, the EC states that the *dynamic baseline scenario* "takes into account relevant initiatives at various levels (EU, OECD and Member States) and assesses whether they address the tax challenges posed by the digital economy".[24] In this assessment, the Commission refers to two aspects that are important: First, do the initiatives effectively address structural shortcomings of the current international tax system? Second, do they reduce specific tax avoidance opportunities that businesses of the digital economy can apply more easily than other companies?[25] The following paragraphs will shortly outline the initiatives already taken at the EU and OECD level.

At the EU level, relevant initiatives as of this date include the implementation of the Common (Consolidated) Corporate Tax Base (CCCTB), the Anti-Tax-Avoidance Directive and the EU finance ministers adopted package on VAT in e-commerce. Some of the challenges with these measures will be outlined below.

Issues with the *CCCTB rules* include that "companies not subject to mandatory application would remain subject to the standard profit allocation rules",[26] and that for companies that do fall under the scope of the rules, the rules are not different from those already applying internationally. Additionally, the CCCTB rules do not provide solutions to "cases where sales by destination do not capture well the economic activity of the company (and neither do tangible assets or employment)".[27] On the other hand, the rules are deemed to mitigate the problems tied to profit shifting, although they do not address the artificial avoidance of permanent establishments. An issue with t*he legally-binding anti-avoidance rules* established at the EU level, is that they are not expected to deal broadly with the specific challenges of the digital economy. In fact, the CFC rules "only address situations where the ultimate parent company is a taxpayer in the EU".[28] And, although the EC in its Recommendation in 2016 on Tax Treaty issues endorsed the view that Member States implement the new provisions on permanent establishments, these are not legally binding, nor do they in-depth address the avoidance of permanent establishments by the digital economy.

At the OECD level, important work up until this date includes the final Action 1 report (OECD, 2015a) which

22 Ibid. pg. 23
23 Ibid. pg. 23
24 Ibib. pg. 24
25 Ibid. pg. 23
26 Ibid. pg. 24
27 Ibid. pg. 25
28 Ibid. pg. 25

discusses “the broader direct tax challenges raised by the digital economy”,[29] and the interim report on the implications of digitalization on taxation delivered in March 2018. The report outlines that “broader tax challenges for policy makers relate in particular to nexus, data, and characterisation for direct tax purposes”.[30] Although it remains unclear what a *comprehensive solution* at the OECD level may be, it is clear that work on the solution will include revising the rules on permanent establishments and profit allocation rules. Thus, proposals have been issued demanding that the definition of permanent establishment in BEPS action 7 be amended. On a final note, measures with the purpose of preventing tax treaty abuse have been widely implemented.

Although progress has been made at the OECD level, the revised permanent establishment rules continue to stipulate that businesses must have a physical presence in the country where they operate to be liable for taxes. Further, they continue to mostly target abuse structures used by online retailers of physical goods.[31] As the current design of a permanent establishment does not, then, adequately address the incremental taxation issues in the field of the digital economy, current work at the OECD does not offer solid guidance on possible solutions the EU Commission should implement. At any rate, solutions offered by the OECD are either not binding or stipulated only in bilateral treaties or in the “Multilateral Instrument”, leaving important implementation gaps.[32]

5.3.2 What are the available comprehensive policy options?

To find an interim and comprehensive solution to the new taxation issues arising in the field of international taxation law, the EU Commission has looked into and evaluated several options. Many of these end up discarded. Below will follow a concise outline of the options that were looked into and evaluated as well as short explanations of why some of these were discarded.

The EU Commission has inserted the options into three categories: *fundamental reforms, realignment within current international tax framework* and *design options for a digital permanent establishment.* The outline below will follow this layout.

5.3.2.1 What are the available comprehensive policy options?

A first set of options that were looked into and evaluated but eventually discarded are the following: destination-based tax, unitary tax and residence tax base with destination tax base. These are all characterized as being part of a *fundamental reform*.

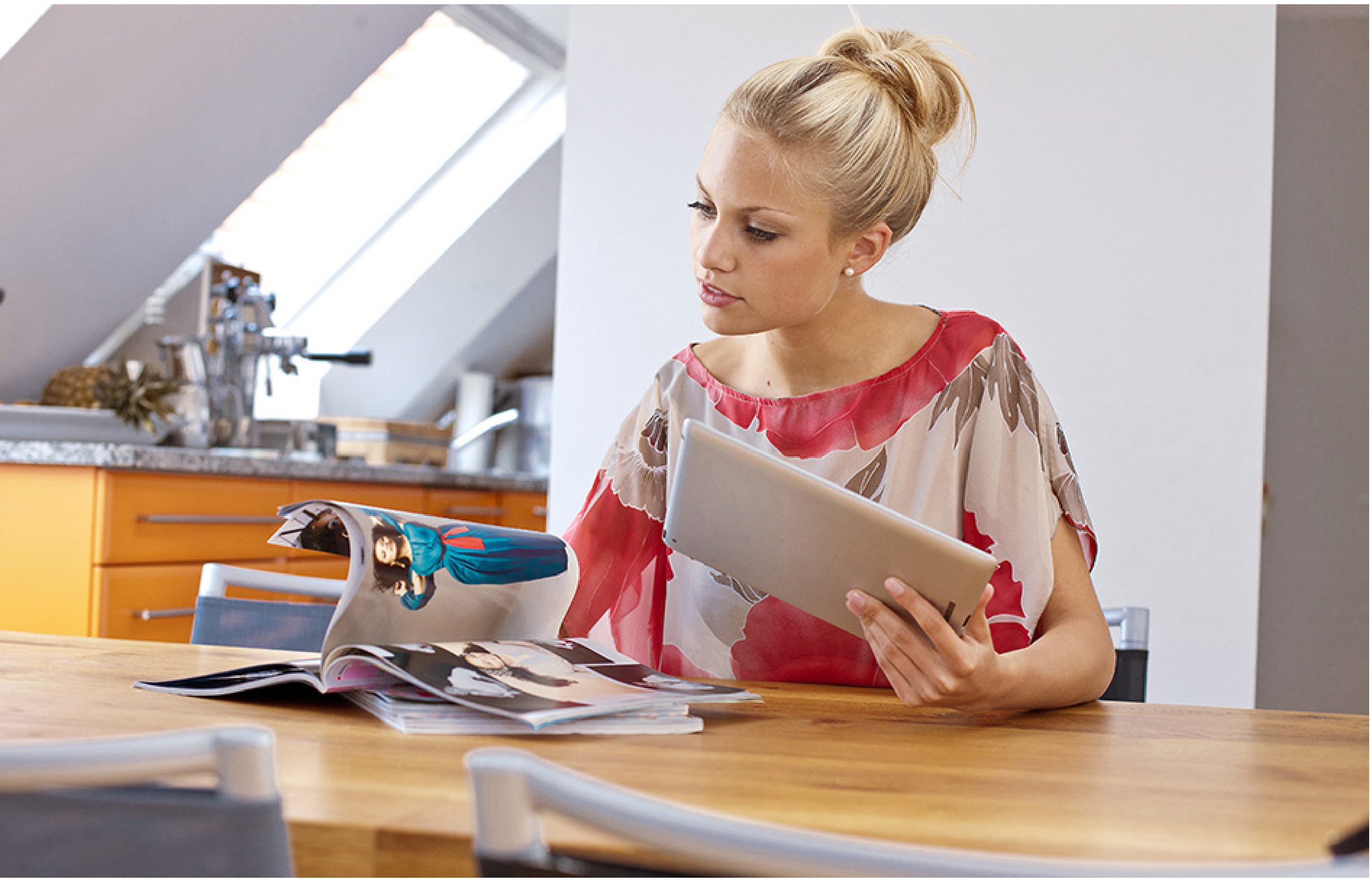
In short, the destination-based tax allocates “the right to tax exclusively to the jurisdiction where the good or service is consumed”;[33] the unitary tax entails that “worldwide consolidated profits are apportioned according to turnover generated in each jurisdiction”,[34] and the residence tax base with destination tax rate establishes that “taxing rights and profit allocation rules remain as they are today, but the tax rate applied to the tax base in a jurisdiction is a weighted average of the tax rates of the countries where the turnover was generated”.[35]

All options are thought to tackle root problems in taxing the digital economy, and in the EC’s opinion, this is especially the case with the the destination-based tax is. However, the implementation of the fundamental reform is deemed such an arduous task that, in sum, it is not a viable option.[36]

5.3.2.2 Options part of realignment within current international tax framework

Another set of options fall within the scope of the characterization *realignment within current international tax framework (new permanent establishment and profit allocation rules):* the intra-EU-narrow scope:

29 Ibid. pg. 26
30 Ibid. pg. 26
31 Ibid. pg. 26
32 Ibid. pg. 27
33 Ibid. pg. 29
34 Ibid. pg. 29
35 Ibid. pg. 29
36 Ibid. pg. 34



Adjustments to the CCCTB rules; intra-EU-wide scope: Directive on new permanent establishment and profit allocation principles + adjustments to the CCCTB rules; the intra-EU-wide scope + mandatory application vis-a-vis third countries, and the intra-EU-wide scope + recommend application vis-a-vis third countries.

Being the only discarded option in this category, the intra-EU wide scope + mandatory application vis-a-vis third countries entails that the EU Member States apply the new rules vis-a-vis third countries. Along with other reasons for why this option was discarded, cf. the Report page 35, the EC points out that the option would require the Member States to break their treaties with third countries.

Moving on to the other options that, to the contrary, were deemed viable, the intra-EU-narrow scope: Adjustments to the CCCTB involves a revision of permanent establishment rules and the apportionment formula in the CCCTB. Essentially, these rules entail that a "digital permanent establishment of an EU company would be triggered in a member State and be subject to corporate income tax on its digital activities once a set of conditions is met".[37] To elaborate, the key condition appears to be that if the company reaches a certain level of digital activity, whether based on revenues from digital services, the number of active users of the digital service or the number of online contracts concluded, a permanent establishment in the applicable Member State is brought about.

The next option accepted as viable is the intra-EU-wide scope + recommend application application vis-a-vis third countries. This option involves recommending EU States to revise their double tax treaties with third countries to reflect the new rules. As such, the option "would be addressed to Member States, but it could also influence the debate at international level on addressing the challenges of taxing the digital economy".[38] To implement these rules, the EC would, where this is of particular interest, seek a mandate to negotiate the revisions vis-a-vis third countries.

In sum, the intra-EU-narrow scope: Adjustments to the CCCTB and the intra-EU-wide scope + recommendation application vis-a-vis third countries and the intra-EU-wide scope + recommend application vis-a-vis third countries by the EC, are deemed to be viable options. The impacts of these options will shortly be outlined in 5.4. below.

37 Ibid. pg.31.
38 Ibid. pg. 33

5.4 The impacts of the intra-EU-narrow scope: Adjustments to the CCCTB rules; intra-EU-wide scope: Directive on new permanent establishment and profit allocation principles + adjustments to the CCCTB rules and the intra-EU-wide scope + recommend application vis-a-vis third countries.

5.4.1 The impacts of option 1: the intra-EU-narrow scope: Adjustments to the CCCTB rules

At the outset, the EC establishes that this option would apply to companies with a turnover above EUR 750 million, and, as such, not apply uniformly to all businesses. In further discussing the impact of these rules, the EC looks to the impact the rules have on the integrity of the market; sustainability of public finances; social fairness and the playing field among businesses; the fight against aggressive tax planning; economic impacts; administrative burden and compliance costs, and the coherence with other Commission policies and global tax agenda states. Below follows a summary of how the rules impact these factors.

As the rules would not, as stated, apply uniformly to all businesses, eliminating the risk for unilateral measures by the Member States, the integrity of the market would not be adequately safeguarded. Also, the EU Commission expresses that "introducing a solution that is contingent upon application of the CCCTB introduces new distortions in the single market".[39] By example, the EU states that the situation could be that a company *not* applying the CCCTB rules pays taxes only in one Member State whereas the same company would pay taxes in *all* Member States if it applied the CCCTB rules. Introducing a solution that is conditioned on the application of the CCCTB would also make the decision on whether to apply the CCCTB rules more complicated than before.

Concerning the impact the rules would have on the sustainability of finances, the EC establishes that no considerable tax increase at EU level is expected, although there "will likely be a certain amount of reallocation of tax revenue across Member States"[40] Turning to how the rules level the playing field among businesses and contribute to social fairness, the EC establishes that the CCCTB, along with effectively taxing digital activities, will level the playing field between digital and less digital companies adhering to the CCCTB rules. Moreover, the rules will level the playing field between EU companies operating domestically and EU companies operating remotely.[41]

The rules would also, according to the EC, contribute to fighting aggressive tax planning. Firstly, the rules would prevent tax avoidance through the artificial avoidance of permanent establishments, and secondly, cap the opportunities existing for aggressive tax planning. Further, regarding the economic impacts of the rules, the EC establishes that since the rules will affect a small number of companies, the economic impact will be small. Second to last, the compliance costs and administrative burdens will, according to the EC, notably encompass the establishing of information items such as proxies to identify permanent establishments, but will be "limited" overall.[42] Finally, the EU assures that the proposed rules fit well within the "Commission's initiatives on fairer taxation".[43]

39 Ibid. pg. 36
40 Ibid. pg. 37
41 Ibid. pg. 37
42 Ibid. pg. 39
43 Ibid. pg. 39

5.4.2 OPTION 2: Intra-EU-wide scope: Directive on new permanent establishment and profit allocation principles + adjustments to the CCCTB rules.

At the outset, the EC establishes that this option would, contrary to the intra-EU-narrow scope, not stipulate that companies have a turnover of more than EUR 750 million for the CCCTB rules to apply. In the EC's further assessment of the impact of the rules, the EC follows the same procedure as above, and discusses the rules in light of above-mentioned factors. The discussion is summarized shortly below.

Compared to the intra-EU-narrow scope, the rules will have a stronger impact on the integrity of the market, as they do not apply only to companies with a turnover above EUR 750 million. Regarding the effect of the rules on financial sustainability, the EC establishes that they would "correct existing misalignment of taxation and value creation and contribute to a fairer distribution of tax revenue within the EU".[44] Turning to how the rules affect social fairness and the playing field, the rules will, according to the EC, augment the perception of social fairness and, further, level the playing field by including all digital activities. The latter will also have the benefit of removing competitive distortions.[45]

In terms of how the rules contribute to the fight against aggressive tax planning, the EC highlights that the rules will prevent companies from shifting profits to third countries. And concerning the economic impact of these rules, the rules will, due to their larger scope, have a relatively larger economic impact than the rules discussed in section 5.3.4. Finally, the EC assumes that the rules will entail "only small increases [...] expected in the time spent on record keeping, on the preparation of tax computation and on dealing with the tax authorities",[46] and that the Directive will continue to push progress on taxation issues in the digital economy internationally.

5.4.3 OPTION 3: Realigning profit allocation rules with value creation intra-EU and recommendation to change rules vis-a-vis third countries

Orbis firm level data on affiliates of the set of 112 large digital companies shows that at least 75 % of them have at least one affiliate in the EU. The remaining 25 % are not accounted for in the data.[47] Consequently, the "immediate impact of an application also vis-a-vis third countries might be small". [48] However, the rules would level the playing field between EU and third country companies. As the rules would also "avoid any disincentives to become a tax resident in the EU", the rules would provide for social fairness and have a positive impact on public finances.[49]

5.5 Design options for a digital permanent establishment

The last set of options have the purpose of detailing the new permanent establishment rules, and thus adhere to the category *design options for a digital permanent establishment*. This set of options outlines possible criteria central to finding a permanent establishment. The EC, thus, examines more closely what level and type of digital activity should be required for a permanent establishment to be triggered.

Regarding what *type* of digital activity should be

44 Ibid. pg. 40
45 Ibid. pg. 40.
46 Ibid. pg. 42
47 Ibid. pg. 43
48 Ibid. pg. 43
49 Ibid. pg. 43.

required, the EC sets out two options: Option a1, which includes the online sale of goods, and option a2, which excludes the online sale of goods.[50] The EC concludes that *all* types of digital activity should be included.[51]

Regarding what the threshold should be based on and how it should be applied, the EC sets out factors central to determining the digital activity threshold: firstly, the threshold must account for the various types of business models; secondly, the threshold must not capture businesses barely able to pay compliance costs and other burdens tied to the rules, and thirdly, the threshold must ensure comparable treatment in different Member States, irrespective of their size.[52]

Turning specifically to what the threshold should be based on, the EC states that numerous alternatives have been recommended, the following three being the most often discussed: a threshold based on revenue earned from customers/users in the jurisdiction; a threshold based on the number of users (based on a concept of "monthly average users"), and the number of online contracts (agreements to terms of service).[53] Additionally, the EC evaluates *how* the threshold should be applied: in an alternative way (i.e. as soon as one of the thresholds is exceeded, the permanent establishment is triggered); in a cumulative way, or in combination with other thresholds, which can apply alternatively.[54]

The EC concludes that the thresholds should be applied alternatively. This has the benefit of dealing "effectively with respect to the advertising business model that generates revenue not directly from its users but indirectly through sales to third parties".[55] Concerning, then, how the threshold based on revenue should be set, the EC sets out that the "starting point for setting the revenue threshold are the estimated costs for operating an additional permanent establishment".[56] And regarding how to set the threshold based on the *number of users*, the EC establishes that "data for the revenue per user is informative".[57] In relation to how the threshold based on the *number of online contracts* (agreements to terms of service) should be set, the Commission recommends a high threshold if the "acceptance of 'terms of service' for the use of an online platform could be assimilated to the conclusion of a contract". [58] A lower threshold should, on the other hand, be considered if the threshold is based on business-to-business contracts - for example cloud-computing services, which typically have relatively few "users".[59]

50 Ibid. pg. 33
51 Ibid. pg. 50
52 Ibid. pg. 45
53 Ibid. pg. 45.
54 Ibid. pg. 33.
55 Ibid. pg. 45.
56 Ibid. pg. 46
57 Ibid. pg. 46.
58 Ibid. pg. 47.
59 Ibid. pg. 47.

5.6 Impact on small and medium-sized enterprises

As Option 1 applies only to businesses with a turnover above EUR 750 million and Options 2 and 3 require that the threshold of digital activity to be met, small enterprises will not be affected by the new rules. As companies that are active in at least two countries often will exceed the thresholds to be met for digital activity, some *medium-sized companies* may, on the other hand, be affected by the rules.[60]

5.7 How do the comprehensive options compare?

The EU Commission considers that all the options outlined in the above to some degree are effective in "achieving the various objectives set out for this initiative" (see section 4 in this paper). Regarding potential costs, Option 1 - not applying uniformly to all businesses- carries with it the risk that Member States will take unilateral action. As this option, then, entails additional burdens, it is deemed to only moderately affect the above-mentioned objectives. Option 2 is deemed to be similarly effective. Although Option 3 is similar to Option 1 and Option 2, it is deemed to be the *most* effective "due to its stronger impact on a more level playing field and fight against tax planning".[61]

Pointing to a stakeholder consultation, the EU Commission sums up that the proposal for a "digital presence in the EU is the preferred approach for more than half of the respondents to the stakeholder consultation".[62] In determining how to ensure that this preferred type of measure is proportionate, the EC establishes that "including only digital services in the material scope (Option a2), and not the online sale of goods, accompanied by appropriate digital activity thresholds" is required.[63]

Preferred comprehensive solution

The EU Commission finds that the preferred comprehensive solution is implementing the Directive on digital permanent establishment and profit allocation rules, which should be included in the Common Consolidated Tax Base (CCCTB) negotiations.[64] In short, the Directive would "establish common rules for a digital permanent establishment and for allocating profits to digital activities of such permanent establishments".[65] And as stated above, this will entail that once a digital activity threshold is met, a permanent establishment is brought about.

The Commission further states that "a significant part of the value of a business is created where the users are based and data is collected and processed, additional criteria specifically and exclusively targeted at these aspects would be added to profit allocation principles".[66] And, lastly, the Commission adds that as before, Member States will continue to apply their "national corporate income tax rules with respect to the profits attributable to a digital permanent establishment in their jurisdiction".[67]

The preferred options also entails a recommendation to the Member States to implement digital permanent establishment and profit allocation rules in their double tax treaties.

60 Ibid. pg. 47
61 Ibid. pg. 48.
62 Ibid. pg. 49.
63 Ibid. pg. 49.
64 Ibid. pg. 50
65 Ibid. pg. 50
66 Ibid. pg. 50
67 Ibid. pg. 50

5.8 Interim Solution

The *general objective* for the interim solution is the same as for the comprehensive solution, but the *specific objective* is different: The specific objective is to create tax targeting business models that are easy to implement and improves the level-playing field and fair taxation in the interim period until the comprehensive solution is implemented.[68]

5.8.1 What Is The Baseline Against Which The Interim Solution Is Assessed?

As the main purpose of the interim measure is to take action to meet the incremental taxation issues arising in the new *digital economy* era until a comprehensive solution is set, the interim solution will be "assessed against a scenario, in which the preferred comprehensive solution is not yet in place[...]". Additionally, particularly to prevent unilateral measures by Member States, the solution must be quick and easy to implement. As seen in table 6, several Member States have either already taken unilateral measures, or have concrete plans to do so.

5.8.2 What Are The Available Interim Options?

The EU Commission establishes that available interim options must "reconcile with the current (international) tax framework".[69] Notably, the interim measure must fit in with important tax frameworks such as the "EU treaties, the rules implied by membership of the World Trade Organisation, and other international commitment, for example through the Inclusive Framework of the OECD multilateral, double tax treaties, and the EU rules for VAT".[70] Available interim options must also be fairly quick and easy to implement and should preferably be in line with earlier measures enacted to meet taxation challenges in the era of the digital economy.

Against this backdrop, the EU Commission finds that raising "VAT rates on digital services" and "tax[ing] profits" are not feasible options as they run counter to respectively the EU VAT framework and various double tax conventions."[71] Similarly, a tax on profits, although theoretically more efficient, is discarded on the grounds that it would interfere with "double tax conventions".[72] Furthermore, the Commission rejects introducing a "transaction tax on those digital services that are remunerated by users through the provision of data is[73]" as its implementation would be too difficult.

In conclusion, the Commission finds that a revenue tax is the most viable option. Important grounds for this conclusion is that such a tax would be in line with earlier approaches made by the OECD in drafting interim solutions to the taxation of the digital economy, and in line with the unilateral measures already taken by, or about to be taken by, Member States.[74]

Below, the details of the revenue tax will be outlined.

Design options of a revenue tax on digital services
In its assessment paper, the EU Commission specifies the scope of the rules in great detail in light of the following: material scope; whether the rules depend on a threshold being met, and, if the answer is in the affirmative, what the level of the threshold should be; the tax rate; the tax revenue potential; the level of additional tax imposed on companies; how taxes will be allocated; relief of double taxation, and collection of taxes.

---

68 Ibid. pg. 53
69 Ibid. pg.55
70 Ibid, pg. 55
71 Ibid, pg. 56
72 Ibid, pg. 56
73 Ibid, pg. 56
74 Ibid, pg. 55

- material scope (which activities are covered)
Before defining the specific scope of the revenue tax on digital services, the Commission states in general that the tax must "apply to resident and non-resident companies alike, as well as to domestic and cross-border transactions".[75] Furthermore, solutions to *double taxation issues* must be drafted. Proposed solutions include crediting corporate tax against already paid the new tax or vice versa, and allowing for deductions of the revenue tax against the corporate tax base. These are discussed below. Additionally, the Commission establishes that not applying any interim solutions is unacceptable, particularly in light of the risks of distortions of the market due to unilateral measures by the Member States. [76]

Turning to what the *specific scope* of the revenue tax should be, the Commission expresses that a "key principle to respect when addressing challenges in taxing the digital economy is the taxation of profits where the value is created, along with the aim to create simple rules".[77] As the interim solution also needs to be easy and quick to implement, the EU Commission establishes that the revenue tax will be based on user contribution. In short, user contribution involves several factors such as "technology (such as an algorithm), knowledge and user contribution",[78] and is generally is a central aspect of most business models.

The concept of user contribution can be defined in three ways: in a broad sense, which entails taxing *all* business models as previously described; in a narrow sense, which means taxing only"business models where the user contribution plays a central role in the sense that the service would not exist if the user did not contribute to it",[79] and in a mixed sense which means "levying [...] tax on a broader scope than the narrow one by adding other services where user contribution is significant but maybe not essential".[80]

In determining which of the three approaches should apply, the Commission looks to which option best prevents further fragmentations of the single market, improves fair taxation, is simple to implement and carries the lowest risk of taxing too heavily services that play a key role for the development of the digital single market. On this background, the Commission finds that either the narrow scope or the or the (selective) mixed scope is the best option. As the narrow scope may have the best economic impact as it "notably [...] minimises additional distortions, while still having broadly the same revenue potential as the mixed scope",[81] however, the Commission seems to *favor*, overall, the narrow scope.

-application and level of a revenue threshold
At the outset, the Commission states that there are "good reasons to apply some form of revenue threshold".[82] To name a few, "larger companies are more easily able to engage in aggressive tax planning [...]", and "a certain scale is necessary for companies to benefit from user contributions and network effects".[83] And turning to whether the threshold should be based on all revenue or revenue only from relevant digital services, the Commission establishes that as some companies, particularly smaller ones, may not record separately revenues from the services falling under the material scope of the new tax, "a threshold on general turnover would greatly limit the extra burden imposed on companies and provide important legal certainty".[84] On the other hand, the Commission admits it may seem "unreasonable to impose a tax on a company above the general threshold, which has only minor relevant digital services in the EU".[85] As both approaches have their own rationale, the Commission does not conclude on which approach is preferable. It is lucid, however, that some kind of threshold must be applied.

Regarding the *threshold level*, the Commission, in

75 Ibid, pg. 57
76 Ibid. pg. 60
77 Ibid. pg. 61
78 Ibid. pg. 61
79 Ibid. pg. 58
80 Ibid. pg. 58
81 Ibid, pg. 66
82 Ibid. pg. 66
83 Ibid pg. 66
84 Ibid. pg. 66
85 Ibid. pg. 67

addition to defining a *general turnover threshold*, proposes a “complementary specific threshold set at EU level on the annual revenues from the provision of taxable digital services could further limit the application to the most significant cases”.[86] On this background, then, and to ensure proportionality of the measure and to avoid “hurting the digitalisation of the economy and not be discriminatory against non-resident companies”,[87] the tax would apply to businesses being above both of two thresholds: 1. “An annual worldwide total revenue above EUR 750 million, at the level of the multinational group to which the business belong, if applicable. 2. Revenue from the provision of digital services above a threshold of EUR 10-50 million”.[88]

-tax rate, tax revenue potential and the level of additional tax imposed on companies
The Commission also discusses the tax rate and the tax revenue potential and the level of additional tax imposed on companies. The tax rate will be levied at a *single rate*. As to the tax revenue potential, the Commission states that both a “top-down and a bottom-up estimation of expected tax revenue conclude that the expected additional revenue collected from the tax would be rather moderate, but with significant growth potential over the next years”.[89] Regarding the level of additional tax imposed on companies, the Commission outlines that since “costs are not taken into account, the corresponding tax on profits implied by the tax on revenue, even at a low rate, could be substantial for individual companies”.[90] To illustrate, the Commission sets the following example: if a company that has EUR 100 of gross revenue and EUR 85 of (deductible) costs, it has a mark-up of 15 %. If it pays a tax on gross revenue of 2 %, it has to pay EUR 2 in revenue tax, which corresponds to a profit tax of 2/15 = 13 %. If a tax on revenues from digital services is deductible from the corporate tax base, the implied profit tax rate reduces to about 10 %.[91] Further, according to the Commission, the rate “should be decided taking into account both the amount of revenue generated form the tax and possible distortions from a business perspective”.[92]

-allocation of taxes
Two approaches can be made to the question of how taxes shall be allocated: tax can be collected based on user *location* and based on *where payments* have been made. Although allocating tax based on where payments are made would be the easiest solution both for companies and tax administrations[93], the Commission highlights that since the rationale for the interim solution is to “be a good and simple interim proxy to deal with the most extreme cases where users contribute a very significant share of the value”[94], allocating taxes based on *user contribution* is the best option. In specific cases, however, one can deviate from this approach, for instance in online advertising cases, where it could be better to allocate taxes based on the number of times a user accesses a displayed advertisement.[95]

-relief of double taxation
In discussing methods for alleviating double taxation issues, the Commission finds that one should “[allow for] the deduction of the new tax as a business expense from the corporate tax base”[96]. This approach is preferred over crediting corporate tax against already paid the new tax or vice versa as stated above. Further, the Commission establishes that there is “no risk of taxing the same service twice under the new tax”. If, however, revenue is associated to, for instance, an online advertising service and an online marketplace service, one would, according to the Commission, “take precedent over the other to ensure that the same revenue cannot be taxed twice”.[97]

86 Ibid. pg. 68
87 Ibid. pg. 78
88 Ibid. pg. 78
89 Ibid. pg. 69
90 Ibid. pg. 71
91 Ibid. pg. 71
92 Ibid. pg. 71
93 Ibid. pg. 72
94 Ibid. pg. 72
95 Ibid. Pg. 72
96 Ibid. pg. 73
97 Ibid. pg. 73

-collection of taxes
As enforcing withholding taxes on payments entails "technical and procedural difficulties" deemed to be "insurmountable", the EU Commission instead invites the Member States to use a self-declaration system.[98] This system has, according to the Commission, several benefits: Along with being suitable for modest tax collections as will be the case in applying the interim solution, companies are also, in general, already familiar with this system.

-other economic impacts of tax on revenues from digital services
To start, the Commission expresses that taxes on revenue is efficient under a number of circumstances. Firstly, a turnover tax proves to be "better than a profit tax in terms of social welfare".[99] The reason for this is that such a tax significantly reduces tax avoidance and erosion. Although a turnover tax may, however, result in a loss of production efficiency, this is "more than compensated for by the increase in revenue efficiency due to larger compliance".[100] Further, since the tax would have a fairly narrow scope and because it affects business models with a large user base, the Commission believes *cascading issues* to be kept at a minimum.[101] And, despite limited evidence on "the pass-on effect of a new tax on turnover", economic theory and VAT experiences suggest "that there is no uniform answer for the variety of digital services considered".[102] For online retail, however, evidence indicates that online purchasers react strongly to price increases, which limits "the possibility for companies to pass additional tax on to consumer prices". [103]

-administrative burden and compliance costs
As businesses "must identify gross revenues from supplying digital services and relevant user statistics" and must declare and pay taxes to Member States assigned with the relevant taxing rights, the new rules require additional reporting requirements.[104] And, since the rules might "cover several different business models even for the same enterprises, taxpayers will have to further allocate internally revenues to various proxies (for example, number of active users and monetisation by user, local domain names, IP addresses, number of visits, number of clicks, number of ad displays, location of the accommodation, transport, entertainment services provisions".[105] According to the Commission, it will not be an arduous task to collect relevant data to determine whether the business is in compliance with the new rules, nor are additional tax compliance costs expected to be large. For non-resident taxpayers the compliance costs and administrative burdens may, however, be slighter higher than for resident taxpayers. And as far as the burdens and compliance costs for national administrations goes, the "interim solution has initial set up costs limited to reporting adjustments, declaration and payment (in terms of both procedures and IT systems) and the corresponding staff and training costs".[106] For tax administrations levying taxes on non-resident taxpayers, the tax collecting process may be cumbersome and thus costly, but according to the Commission, these can make use of the administrative tools available at the EU or OECD level.[107]

-coherence and articulation with the comprehensive solution
The EU Commission expresses again that the interim solution will be in line with the comprehensive approach, one of the most important guidelines in formulating the interim solution. Upon implementation of the comprehensive solution - the Directive on digital permanent establishment and profit allocation rules rules, adoption of the adapted CCCTB and Recommendation to revise double tax treaties-, the interim solution would cease to exist.[108]

For more details on these discussions, see pages

98 Ibid. pg. 74
99 Ibid. pg. 75
100 Ibid. pg. 75
101 Ibid. pg. 74
102 Ibid. pg. 75
103 Ibid. pg. 75
104 Ibid. pg. 76
105 Ibid. pg. 76
106 Ibid. pg. 77
107 Ibid. pg. 77
108 Ibid. pg. 78

5.8.3 Preferred Interim Option

Conclusion and description of the preferred interim solution

Following the discussions above, the Commission concludes that "the preferred interim solution is a Directive on a common system of a tax on certain digital services". As stated, this measure carries a "narrow scope, levied on the gross revenues of a business resulting from the exploitation of digital activities characterised by user value creation, namely advertising revenue and revenue from services provided by online marketplaces/intermediaries"[109], and would ensure simplicity.

Regarding the threshold, the tax would apply to businesses being above both of two thresholds: "an annual worldwide total revenue above EUR 750 million, at the level of the multinational group to which business belong, if applicable, and revenue from the provision of digital services above a threshold of EUR 10-50 million".[110] The single rate would amount to 1-3 %, and taxes would be deductible from the corporate tax base.

Moreover, taxing rights would be assigned according to user location. As mentioned above, this approach is better in line with the aim to match taxing rights with where value is created. Lastly, the EU Commission underlines that the preferred option is consistent with the principle of proportionality and that it does not exceed what is necessary in order to ensure the proper functioning of the single market.[111]

5.8.4 Summary of the ECOFIN report dated September 2018

On September 21 2018, the Committee on Economic and Monetary Affairs published two draft reports discussing possible solutions to new and urgent taxation issues in the field of the digital economy: The first report, "Corporate taxation of a significant digital presence", discusses a *comprehensive solution*, and the other, "Common system of a digital services tax (DST) on revenues resulting from the provision of certain digital services", discusses an *interim solution*. In line with the Commission's work, the idea is that the comprehensive solution, once completed, will replace the interim solution and provide a final solution to the new and urgent taxation issues.

The ECON draft report proposes, inter alia, changing the tax rate from 3 % to 5 %. The discussion paper also proposes expanding the tax base to include the supply of digital content such as video, audit or text and the sale of goods or services contracted online via e-commerce platforms. Further, the proposal stipulates that the European Commission issue guidelines on how to define, measure and tax a *significant digital presence and digital services*.

If MEPs wish to, for instance, add comments or make adjustments to the ECON draft report, this must be done by 16 October 2018. Tabled comments and suggested adjustments will be considered by the ECON Committee in its meeting on 19 November 2018. The final vote on both reports will take place in the EU Parliament's Plenary Session on 17 January 2019.

As there will be no formal EU Parliament Opinion/Resolution by 4 December, no political agreement, i.e. formal decision on this dossier, will be reached by this date. Importantly, according to the Treaties for the Council, the unanimous opinion of the EU Parliament, the sole legislative body on tax matters, is required to reach a final decision.

---

109 Ibid. pg. 78
110 Ibid. pg. 78
111 Ibid. pg. 80

6

Discussions - Are the solutions presented by the OECD and Commission sufficient to reach the aim of fair taxation and balanced taxation rights?

6.1 OECD level

Based on the progress that has been made at the OECD level, summarized above, we do not find it likely that the recommended OECD BEPS measures, which aim to create "a modern corporate tax framework which allows for the fair and efficient taxation of the digital economy" by aiming to ensure location taxation (PE threshold), are sufficient to reach the goal of fair taxation and balanced allocation of taxing rights in the digital economy. For this reason, further action in the field of digital economy seems to be required. Below we will discuss the main arguments for why we take this position.

Firstly, the BEPS measures do not adequately address the emergence of new business models. In short, this is because contrary to how traditional business models operate, new business models, continuing to rise in number, do not require the same level of physical presence in any given country to successfully conduct business. Rather, businesses increasingly operate remotely, not requiring physical offices or staff in the country they operate in and generate revenues (so-called "scales without mass"). Moreover, in our opinion, the BEPS measures give rise to implementation issues. This is mainly due to the fact that relatively few IF Member States have agreed to revise their treaties to include the measures dealing with location taxation (PE threshold), a prerequisite, of course, to making them operative. Consequently, it seems likely that the current measures taken at the OECD level will have only a marginal effect on stopping unilateral measures taken by the Member States, which is central to achieving fairer allocation of taxing rights.

Despite fairly obvious shortcomings to the OECD BEPS measures in capturing salient features of the digital economy, the IF Members are committed to working together to reach a consensus-based solution by 2020 (an update on the progress is scheduled in 2019). Assuming this work does not culminate in specific actions, e.g. an expansion of the PE (digital nexus) and revised principles for attribution of profits to digital PE's, we believe the implementation of unilateral measures is likely to increase.

A question that is currently debated to a great extent amongst IF Members and others and that deserves specific attention, is where value in fact is created and who is responsible for it. Currently, a conclusion regarding these questions is not drawn. As of now, there are grounds to believe that it might be some time until the IF Members are able to agree on where value creation takes place and who is responsible for it, as answers to these questions will be vital in designing what tax rules apply. However, on a more positive note, the IF Member States do, at the least, agree that agreeing on these questions is crucial to designing a framework that enables fair taxation and more balanced allocation of taxation rights. We are of the same opinion and encourage further work in this field.

6.2 EU level

Overall, we believe the comprehensive and interim solutions introduced at the EU level might be suited to meet the goal of fair taxation and more balanced taxing rights. In the following paragraphs, we will briefly discuss the pros and cons of both solutions and provide the background for why we, in sum, believe these solutions might meet this goal. Pros and cons of the comprehensive solution will be treated first in 6.2.1., and pros and cons of the interim solution will be treated in 6.2.2. Paragraph 6.2.2. will also discuss whether the Nordic governments should consider imposing domestic measures on their own in the wait for a comprehensive solution, as this discussion is closely related to whether the interim solution - in the aggregate - is fit to meet the goals of fairer taxation and more balanced taxing rights in the wait for a comprehensive solution.

6.2.1 Is the comprehensive solution fit to meet the aim of fairer taxation and more balanced taxing rights?

Pros of the comprehensive solution include that it is more in line with what is discussed at the OECD level, increasing the chances of it becoming the global solution to the taxation issues currently prevalent in the digital economy.Another positive point is that the solution is in line with current rules on taxation of profits of PE's and rules on avoidance of double taxation, possibly increasing the probability that the states reach a consensus on implementing it. Further, as for any coordinated solution, the comprehensive solution would also put a stop to uncoordinated, unilateral measures taken at the state level, abating the effects this has on fragmenting and distorting the market, this aspect of the comprehensive solution appears to be strongly positive. An additional positive point is, in our opinion, that the proposed thresholds for significant digital presences will effectively scope out SMEs and micro businesses and thus be limited to capturing MNEs that derive global and local income exceeding the thresholds.

On the other hand, and turning to the cons, the comprehensive solution entails that states need to re-negotiate treaties they have with third countries to enact the provisions. And, since the comprehensive solution does not provide adequate guidance on central points of dispute between the Member States - what the taxable nexus should be, where value is created and, in turn, what principles of attributing profits should be applied-, core questions on how the tax rules should be defined remain unanswered. For instance, it has been argued by some that the profit split method, which serves to provide answers to the question of how much of the tax rights can be allocated to the source state, is designed for conventional businesses, and not modern, digital businesses.

On this background, although we believe the comprehensive solution represents the most feasible solution in concept, to ensure that it is workable also in practice, more work is required to find and agree on the relevant nexus criteria, i.e. the relevance of the users and user contributions and which principles of profit attribution, other than the profit split method, should apply

6.2.2 Is the interim solution fit to achieve the aim of fairer taxation and more balanced taxing rights, should the Nordic governments consider imposing domestic measures on their own in the wait for a comprehensive solution, and what is the likelihood of the DST being implemented by the end of 2018?

In the next paragraphs, we will discuss whether the interim solution - as a temporary measure- is fit to achieve the aim of fairer taxation and more balanced taxing rights. Included in the below discussions are thus pros and cons for the proposed solution. As the evaluation of the pros and cons will also shed light on whether the Nordic governments should consider imposing domestic measures to temporarily level the playing field until a more comprehensive solution is in place, discussions on this matter will also follow. Additionally, we will provide a short evaluation on how likely it is that the DST is resolved by the end of 2018.

First, since that the current proposal allows for the DST to apply only to MNEs and entities above a certain size, effectively scoping out SMEs and micro entities, the DST appears to meet its own goal of functioning as an interim proxy to deal with the most extreme cases where users contribute a very significant share of the value. Further, we agree with the EC that the interim solution will most likely decisively decelerate the rate at which Member States are taking unilateral measures. This is important, as uncoordinated measures at the state level create fragmentations and distortions in the Single Market. It is also important that actions are taken quickly, as the introduction of unilateral measures at the Member State level do not, as of today, seem to be slowing down, cf. the table below for an overview of measures that are either already, or about to be, taken in the EU and third countries since our 2017 Report.

Country	Planned/ adopted/ implemented	Type of tax
Indirect taxes[112]		
In the European Union		
Hungary	Implemented (2014), amended (2015, 2017)	Tax on advertisement
UK	Planned (2019)	Withholding tax on revenues derived from intermediation and the provision of online advertising
Italy	Planned (2019)	Tax on digital business-to-business transactions of electronically supplied services
France	Implemented (2003), amended (2016)	Levy on access to content, including digital content by means of a video-on-demand / over-the-top online platform (for the cinematography fund)
Germany	Implemented (2004), amended (2010)	Levy on access to content, including digital content by means of a video-on-demand / over-the-top online platform (for the cinematography fund)
Romania	Implemented (2005), amended (2008)	Levy on access to content, including digital content by means of a video-on-demand / over-the-top online platform (for the cinematography fund)
Croatia	Implemented (2007)	Levy on access to content, including digital content by means of a video-on-demand online platform (for the cinematography fund)
Portugal	Implemented (2007)	Levy on access to content, including digital content by means of a video-on-demand online platform (for the cinematography fund)
Belgium (certain regions)	Implemented (2009)	Levy on access to content, including digital content by means of a video-on-demand online platform (for the cinematography fund)
Czech Republic	Implemented (2012)	Levy on access to content, including digital content by means of a video-on-demand online platform (for the cinematography fund)
In third countries		
United States (certain states)	Implemented (2015-2016)	Levy on access to digital content and streaming services

112 VAT on digital services is not included here.

India	Implemented (2016)	Levy on the provision of online advertisement services by non-residents
Canada (certain states)	Planned (2018)	Levy on access to digital content and streaming services
Brazil (certain states)	Planned (2018)	Levy on access to digital content and streaming services
Direct tax initiatives (anti-abuse and new approaches to define a significant economic presence for tax purposes)		
In the European Union		
UK	Implemented (2015)	Diverted profits tax
Italy	Adopted (2017), in force (2018)	Administrative procedure for large non-resident multinational enterprises
Slovakia	Adopted (2017), in force (2018)	Tax on income derived from intermediation through websites and online platforms
In third countries		
Israel	Implemented (2016)	The significant economic presence test for non-resident enterprises
Australia	Implemented (2017)	Diverted profits tax and additional anti-avoidance rule for large non-resident multinational enterprises
India	Planned (2018)	New concept of significant economic presence
United States	Adopted (2017), in force (2018)	The introduction of the concept of a 'base erosion anti-abuse tax' (BEAT) for large multinational enterprises

Source: European Commission analysis based on various sources, such as national legislations, replies to the Member State consultation or other government sources, websites of national film funds, European Film Agency Directors (EFADS) website, website of the International Bureau of Fiscal Documentation (IBFD - for most of the direct tax initiatives) and Thomson Reuters Tax & Accounting for the US BEAT measure.

Additionally, in the recently published 2018 Budget the UK stated that a Digital Service Tax ("UK DST") will be introduced from April 2020.[113] According to the 2018 Budget the UK DST applies a 2% tax on the revenues of specific digital business models where their revenues are linked the participation of UK users. The tax will apply to: search engines; social media platforms; and online marketplaces as the UK government considers that these business models derive significant value from the participation of their users. According to forecasts made by the UK Treasury, "the UK DST will raise £1.5 billion over four years and ensure digital businesses pay tax in the UK that reflects the value they derive from UK users".[114]

However, although the material scope of the interim solution appears to only target MNEs and is fairly well fit to prevent uncoordinated, unilateral measures, the implementation of it may bring about a series of potential issues. The Finnish Finance Minister, Petteri Orpo, has, for instance, stated that the proposal "is not very good", the main point being that it would not collect much revenue (5 billion EURO). Consequently, the situation could be that Member States generate barely enough revenue from the DST tax to cover costs tied to the implementation of the rules. The latter point is, in our view, important: Since the interim solution serves only as temporary solution, it should not incur costs and burdens unproportionate to its benefits. On this background, we encourage further assessments and calculations of what the costs of implementing the interim solution (i.e. costs tied to the collection procedures) will be.

Another point that weakens the solution is that the legality of the interim solution has been questioned in a confidential legal opinion from the EU Council by EU's lawyers. In the legal opinion, it is stated that the digital turnover tax would not constitute an "indirect tax" on companies, raising doubts about the correctness of the legal basis under which it has been proposed. The EU Commission, however, strongly disagrees with the position taken by the lawyers, stating it is "convinced" that the legal basis for introducing the measure is correct, and that the levy indeed constitutes a legitimate tax on companies. Our view is that, taking into account the main features of the DST, the current classification of it is at least questionable as it comes across as a sort of hybrid tax. On this background, it is our view that it cannot be ruled out that the legal basis and classification of the DST will be challenged by others, including third countries that might argue that the 3 % (alt. 5 %) levy is in fact a direct tax that requires treaty negotiation to come into force. Since it is important that the interim solution is implemented in accordance with the law, we encourage that this question is further evaluated before implementation. Further assessment of the legality of the solution is also necessary to ensure that it does not come in conflict with other international agreements and obligations, such as the WTO agreements.

A further point of weakness of the interim solution is that it may create double taxation issues. This is because businesses, without effective credit mechanisms in place, are most likely already paying taxes - either within or outside of the EU. To eliminate the risk of double taxation, the preamble of the draft directive establishes that states of residence will allow for deductions of business expenses. Despite this, it is not, as of today, entirely clear whether this will be followed through on, especially in third countries. Thus, our opinion is that further discussions on this point are also required.

Pinning down a few more possibly problematic issues with the interim solution, it should first be mentioned that the DST may be higher than the corporate tax under the comprehensive solution, possibly creating disincentives for Member States to enact the comprehensive solution. To ensure Member States do not reject the comprehensive solution once it is in place - opting instead to keep the interim solution in place-, equipping the solution with a "sunset clause", as suggested by some Member States, should be considered. Admittedly, states have different procedures for incorporating EU Directives/ratifying new laws, possibly weakening the effect such a clause might have on mitigating the problems.

Some last, pivotal problematic issues with the solution include that it remains unclear where value is created and who creates it. Pinpointing where value is created and who creates it is vital to ensuring that the comprehensive solution operates in line with its goal, but serves a larger purpose as well: Along with playing

113 HM Treasury Budget 2018, Digital Service Tax
114 Ibid

a central role in understanding how digital businesses operate, it will also play a vital role in evaluating whether and to what extent the DST is justifiable and represents a fair allocation of taxing rights. As such, answers to the questions of where value is created and who creates it go to the core of how the tax rules should be designed, and, consequently, are a key matter of dispute between the Member States. As answers to these questions to a large extent are left unanswered, the interim solution is clearly put to a test, and we thus strongly encourage further work and assessment on these matters before the solution is implemented. Furthermore, based on the ECOFIN Draft Report and suggestions to broaden the scope of services of the DST and increase the tax rate, further work also seems to be required in the different bodies of the EU to agree on the main features of the DST.

On the other hand, positive sides of the interim solution include that it will provide companies falling within the scope of it with a certain degree of legal certainty regarding how they will be taxed in the future. In part, this has to due with the fact that the interim solution would put an end to unilateral measures. Another positive aspect is that the implementation of the interim solution will most likely create pressure to implement the comprehensive solution, although it could also be argued that replacing the interim solution with a comprehensive solution shortly after the former's implementation will only inflict costs considerably unproportionate to the benefits achieved by the solution. Additional positive points are, as also argued by others, that the DST to some extent will provide for fairer allocation of taxing rights along with temporarily levelling the playing fields to the benefit of the Nordic media players. A final positive point is that we believe the EC, by taking initiative in this field of conflicting interests, plays a valuable role in pushing progress in this international discussion.

To sum up, the paragraphs above have intended to provide pros and cons for how well suited the proposed interim solution is to meet the goal of achieving fairer taxation and more balanced taxing rights. Although we believe a (global) comprehensive solution is the preferred solution, the interim solution seems, at least in concept, to meet the stated aims. To ensure its practicality, however, the current uncertainties tied to the design of the DST must be clarified. Thus, the DST should, in our opinion, continue to be assessed against all the criteria stated above.

Moving on to the question of what the likelihood is of the interim solution being implemented, there is, in addition to considerable progress being made at the EU level, an abundance of activity at the Member State level regarding what the vote on the interim solution should be. On the supportive side stand, for example, France, Spain and Austria, countries whose vote weighs heavily. This supports the idea that the DST has gained more momentum. On the opposing side stand, typically, Sweden, Denmark, Finland and Ireland,, which only very recently expressed that they do not approve of the DST in its current form.

Although the interim solution is clearly in dispute, it is worth noting that the smaller countries are not likely to go through with a negative veto without the backing of other (larger) countries, leaving it unclear what their final standpoint might be. In our opinion, this leaves Germany the key country to decide the fall-out of the vote. Until recently, Germany has wavered on whether to approve or disapprove of the solution: On Tuesday 6 November 2018, the German Finance Minister, Olaf Schultz, stated that despite the fact that Germany is committed to an international solution, it would consider a revised Commission proposal on an interim digital tax framework if an agreement at the OECD level cannot be reached by the summer of 2020. However, on November 12 German Finance Minister, Olaf Scholz, together with his French counterpart, Bruno Le Maire, rallied their support for the European Commission's DST plans, with the former stating that he wants a deal tied up at a December meeting of EU finance ministers in Brussels[115]. Further, the German newspaper Der Spiegel reports that Scholz has come out in support of the plans, after he had previously taken an ambivalent stance on the European Commission's digital service tax proposal. "If the negotiations continue the way that they have been going, we'll still be in talks in 100 years. That is why I support the French model and want to offer the proceeds to the EU," Der Spiegel quoted Scholz as saying on Monday 12 November.

In light of these very recent changes in the position of Germany, we believe that the chances for the DST being introduced has significantly increased despite the negative positions currently taken by Sweden, Den-

115 See Article in Euractiv.com

mark, Finland and Ireland. Considering these positions and the fact that a unanimous vote is required for the interim solution to be resolved, the future of the tabled proposition remains uncertain.

To add on to the vacillating positions of the Member States, the election of EU Parliament Members is set to take place in 2019. According to leading EU legal scholars, this might, at least during the election year, put off further work on the DST. And, should the DST not be subject to continued debate throughout the year, it remains uncertain when the DST might be tabled as an applicable topic of discussion again.

Considering, finally, the pros and cons of the work ongoing at the EU level and the recently positions taken by Germany, Sweden, Denmark and Finland, we believe that Norway should abstain from introducing measures at the state level, while monitoring the progress at the EU and OECD level. Should, however, the EU fail to find and agree on proper solutions within a reasonable time frame, we believe the Nordic countries should act and consider to introduce an interim measure at the domestic level, mainly to temporarily level the playing field until a coordinated solution is in place at either the EU or the OECD level.

Taking into account the ever-malleable positions of the Member States and the upcoming election of the EU Parliament Members, the future of the DST, and whether the DST will be resolved by the end of 2018, remain highly uncertain.

6.3 Going forward

Although it is uncertain if and when the DST will be agreed on, all of the discussions, debates and recommendations as to how to solve the taxation issues in the field of the digital economy do not leave the impression that work on making progress is in a standstill. Quite the contrary, the Inclusive Framework in the OECD will, as mentioned, continue to labor over reaching a consensus-based solution by 2020 (an interim report is scheduled to be released in 2019). And, despite the different positions taken by EU Member States, , the EU is, as also mentioned, working to find a compromise by the end of the year of 2018. This may prove an arduous task as countries differ vastly in their views of whether the interim solution is viable, some preferring instead a global, comprehensive solution.
To exemplify the diverging views on the matter exhibited by some states, reference can first be made to a joint statement from the Finance Ministers from Sweden, Finland and Denmark. The Finance Ministers expressed the following:

“If we in the EU unilaterally apply a digital services tax on gross income, including to non-EU firms, the tax will be difficult to enforce and there is a substantial risk that it will complicate international cooperation in the tax area. (...) The Nordic countries will continue to participate actively and constructively in such work, and we would support an acceleration of the OECD discussions on this topic, so that we can find a consensus-based solution rapidly”.

And, Eric Robert, Adviser of BEPS, Taxation and the Digital Economy, states that numerous OECD countries are opposed to a short-term solution:

“Regarding unilateral actions and more precisely the proposal made by the EU regarding the Digital Services Tax, I think here clearly when you look at the Interim Report which was released this year, there is no consensus within our membership on the merit, or the need, for immediate and unilateral action. I would add to that, that, speaking from the point of view of the OECD, or the Inclusive Framework, it is in our DNA to try to strive for consensus-based, multilateral solutions. So, we have a natural suspicion towards unilateral, uncoordinated action”.

Further, there is a clear difference between countries quintessentially supporting the interim solutions and countries that do not. Countries typically adhering to the former group include larger countries, as larger countries, presumably, would generate higher levels of revenue from the DST compared to smaller countries, such as the Nordics. By extension, these countries are also frequently exposed to the profit shifting of multinational companies, leading to tax base erosion and a perception that the tax system is unfair. Consequently, leaders of these countries have strongly voiced the opinion that the interim solution be implemented: The French Finance Minister Bruno Le Maire has, for instance, recently offered to facilitate a compromise by offering to add a "sunset clause" to the European Union tax. Under his proposal, the DST would be replaced immediately by the comprehensive solution once it is in place.

On the opposing side of the debate is the U.S., which only very recently strongly discouraged that the DST be implemented. In a letter dated October 2018 from the US Senate Finance Committee to the president of the European Commission President, Jean-Claude Juncker, and the president of the European Council President, Donald Tusk, it asked that the tax be "ditch[ed]". The letter reads:

"The EU DST proposal has been designed to discriminate against U.S. companies and undermine the international tax treaty system creating a significant new transatlantic trade barrier that runs counter to the newly launched US and EU dialogue to reduce such barriers. Therefore, we urge the EU to abandon this proposal, urge the member states to delay unilateral action and instead refocus efforts on reaching consensus with other leading economies within the OECD on any new digital taxation models".

In light of wording of the letter, it could be assumed that the US will impose countermeasures in a case where the DST is implemented. Such possible countermeasures carry the risk of negatively impacting trading and growth in the EU.

On a final note, the DST requires a unanimous vote by Member States to be adopted. As we have mentioned in the above, although there appears to be an increased consensus to the solution, Member States still differ vastly in their views, leaving it highly uncertain whether the DST will reach the required unanimous vote.

6.4 Conclusion

To conclude, we believe the digital evolution will have a profound effect on the economy and business life as a whole. Hence, actions are required in order to update and modernize the tax framework so that it better reflects how business is carried out in the modern world of digital economy.

Considering the ongoing discussions at both OECD/G20 and EU level and the propositions rendered by the Commission, we believe a comprehensive solution, preferably at the OECD level, is preferable to achieve fairer taxation and more balanced taxing rights in the digital world. Further work, however, is required to review, understand and agree on the nexus principles, where value is created and the relevance of the user contributions. The principle of attribution also, in our opinion, should undergo further assessment, particularly because the application of a profit split method on digital business models, as suggested by the EC, may be challenging.

Moreover, although we believe a (global) comprehensive solution is the preferred solution, the interim solution seems, at least in concept, to meet the stated aims. To ensure its practicality, however, the current uncertainties tied to the design of the DST must be clarified. Thus, the DST should, in our opinion, continue to be assessed against all the criteria stated above.

Considering, finally, the pros and cons of the work ongoing at the EU level and the current position taken by Germany, and the fact that Sweden, Denmark and Finland has stated that they do not support the current proposal, we believe that Norway, for the time being, should abstain from introducing interim measures at the state level. Hence, in our opinion, the best solution will be to await and continue monitoring the progress at the EU and OECD level. Should, however, the EU - and the OECD - fail to find and agree on proper solutions within a reasonable time frame, we believe the Nordic countries should act and consider to introduce an interim measure at the domestic level, mainly as an attempt to temporarily level the playing field until a coordinated solution is in place.