



BEPS ACTION 1: ADDRESS THE TAX CHALLENGES OF THE DIGITAL ECONOMY

ICAEW welcomes the opportunity to comment on the public discussion draft *[BEPS Action 1: Address the tax challenges of the digital economy](#)* published by OECD on 24 March 2014.

This response of 12 April 2014 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

Contents

	Paragraphs
General comments	1-6
Sound principles of taxation policy	7-8
Modification of the exemptions from Permanent Establishment Status	9-11
A new nexus based on significant digital presence	12-13
Consumption tax option	14-16
Ten Tenets for a Better Tax System	Appendix 1

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GENERAL COMMENTS

1. We believe that the Digital Economy should not be treated as separate from the “real” economy. In response to the first bullet-point in paragraph 10 we do not believe it is possible to ring-fence the digital economy from the rest of the economy.
2. All parts of the economy demonstrate, or use, to some extent digital methods in carrying on business and some more so than others.
3. Many businesses which use digital carry on their business in a great number of different countries without satisfying the traditional OECD definitions of a Permanent Establishment (PE) and so, under current rules, fail to create a taxable presence in the source country.
4. We do not believe that the solution to this problem should be a major reworking of the existing rules which could have, as an end result, that multinational are deemed to have PEs in a very considerable number of countries and an obligation to make returns in those countries.
5. But it is clear that some multinational business do have a commercial presence in countries which is an integral and essential part of their business model but which do not currently, for instance, meet the conditions to be deemed to have a PE in such countries.
6. We accept that some redefinition of PE is required.

SOUND PRINCIPLES OF TAXATION POLICY

7. We do also very much support the Ottawa taxation framework principles, mentioned in the final bullet-point of paragraph 10, and set out in a Box in paragraph 6.
8. The ICAEW Tax Faculty formulated its own Ten Tenets Towards a Better Tax System in the late 1990s, which are reproduced in Appendix 1 to this response. More recently these have been taken up by the UK Parliament’s Treasury Select Committee in its 2011 Report Principles of Tax Policy
<http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/753/753.pdf> in which it concluded that tax policy should:
 - be fair;
 - support growth and encourage competition’
 - provide certainty;
 - provide stability; and
 - be practicable.

MODIFICATION OF THE EXEMPTIONS FROM PERMANENT ESTABLISHMENT STATUS

9. Various options are put forward in paragraph 211 as to how one could modify the exceptions contained in paragraph 4 of Article 5 of the OECD Model Tax Convention.
10. We support qualifying the Article 5(4)(a)-(d) exceptions to a PE to limit this to where the maintenance of a stock of goods, warehouse etc is itself of a preparatory or auxiliary character, and not an integral feature of the business in question.
11. If there is to be a change of definition then we urge OECD to introduce a number of further examples in the Commentary so that it will be clearer as to what sort of activities will be considered to be of a preparatory or auxiliary character.

A NEW NEXUS BASED ON SIGNIFICANT DIGITAL PRESENCE

12. We are not in favour of extending the PE definition to create a taxable presence because a business has a “significant digital presence”.
13. We are also not in favour of extending the PE definition to the other examples included in paragraph 217 under the heading Virtual Permanent Establishment.

CONSUMPTION TAX OPTION

14. The discussion draft identifies the opportunities presented by the digital economy to make significant sales, cross-border, without creating a taxable presence in the country of consumption.
15. The EU has adopted the 2003 OECD E-commerce guidelines in respect of sales from third countries into the EU but very few, only about 1,000 companies, have registered and account for VAT, and compliance and administration present very great difficulties.
16. The EU is changing its place of supply rules in relation to telecommunications, broadcasting and electronically supplied services within the EU from 1 January 2015 so that from that date the place of supply will be the country of the consumer rather than the producer. VAT is a tax on the value of the sales rather than tax on profit so this is a different taxation approach than direct taxation and we would not recommend it as an immediate option not least because of the difficulty of administering it in practice. But we believe the developments in the EU need to be kept under review by OECD to determine whether such a development may be capable of introduction on a wider geographical front.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see [icaew.com/en/technical/tax/tax-faculty/~media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx](https://www.icaew.com/en/technical/tax/tax-faculty/~media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx))