FISC Workshop on Digital Taxation of the European Parliament, 12 February 2021
Text of the speech by Prof. J. Owens

Good morning!

I would like to use my ten minutes to address three questions:

1. How does the Union get the right balance between addressing the challenges and exploiting the opportunities of digitalization for EU tax systems?
2. What is at stake for the EU in the current G20/OECD debate?
3. What criteria should the European Parliament use to judge any consensus that emerges?

I have prepared a short background note for the committee.

Before answering these 3 questions I would like to make a general comment on the tone of the current international tax debate. Listening to the political debate you may get the impression that our current international tax arrangements are broken beyond repair. Yet the reality is that they have never worked so well: not perfect, yes there are loopholes, and yes, some countries are unhappy with the resulting allocation of revenues but general the system is working well. Why do I say that? Some facts:
We have a Forum – their inclusive framework - where almost all countries are for the first time engaged in the debate (yes some more than others but at least they have a seat at the table).
We have unprecedented cooperation between tax administrations. Multilateralism is very much alive in the tax world.
We have unprecedented dialogue between tax administration and MNES: just look at the spread of ICAP. Yes there are more aggressive audits but at least they are based upon better information and generally are based upon a common understanding of international rules. In addition the number of APA`s are increasing and MAP is working much better than in the past.
Tax Transparency has become the new norm. Yes, it can be painful being in full glare of the sunlight but more transparency will lead to more trust and in the longer term less tax populism.
At the same time our tax systems are on the brink of a transformation coming from new technologies: those we know (AI, ML) and those we are still trying to understand (e.g. Blockchain, quantum computing). I am convinced that these will eventual lead to what the OECD has called the invisible tax administration (not sure I would have chosen that word: shadows of Orwell!), an audit and return free tax environment; with real time compliance; with tax administrations being certifiers of systems (inputs) rather than verifiers of outcomes.

Let me now try to answer the three questions that I posed at the beginning of my presentation.

1. Getting the right balance between risks and opportunities of digitalization:

Much of the current debate has focused on the negative impacts of digitalization such as challenges to traditional tax concepts. For example, the Permanent Establishment (PE) concept which has for a century been the bedrock of tax treaties determining who is allocated the right to tax under tax treaties. Physical presence over a period time (though “permanency” was never actually required) was taken as a good proxy for a significant economic presence which should be subject to taxation of profits made through that presence.
Over the years the PE concept has been adapted to changing business models, though it has its own uncertainties, differing interpretations and issues of practical application. It has at times been abused to

avoid taxation where profits are made, and where citizens and governments expect profits to be taxed as a matter of tax fairness.
Digitalization is not the first challenge to the PE concept, but it is the latest challenge and the response has been that for digital companies we need to go beyond physical presence to identify where the "value" is "created", though there is no clear global consensus on identifying that value, putting a price on it, and identifying where the value is "made" – especially with increasingly complex global value chains.
Much of these debates have focused on how to treat intangibles since these are today the main drivers of the wealth and profits of companies (it is what you know rather than buildings and plants and payrolls that generate profits).
Linked to this is the broader debate on "source" versus "residence" country taxing rights. With global value changes and new technologies such as 3D-printing it is more difficult to have a clear distinction between source and residence countries. Economists would query what tax lawyers regard as the "source country" for income, and it tends to depend on "deeming provisions" in treaties and laws to give some clarification in an unclear area. The matter is complicated for developing countries, as capital importers, tend to prefer source country taxing rights, while developed countries tend to prefer limiting source country taxing rights, as capital exporters. The challenge is that many of the latter countries see themselves as capital importers of highly digitalized services, and seek strong source country taxing rights, while preferring, including for the benefit of their companies abroad, a more residence country-based taxing model internationally. The additional challenge is the difficulty and questionable nature, of any attempt to ring-fence the digital economy from an increasingly more digitalized economy general,
Digitalization also challenges the Arm's Length Pricing (ALP) approach in transfer pricing – the potentially manipulated pricing of internal MNE transactions. This approach is based upon the idea that you can allocate the profits of an MNE on the basis of the separate entity concept, that each component is a separate legal entity. Some commentators believe that the ALP can be adapted to today digital environment, (me included) while still retaining the inherent good sense of looking at market pricing; others consider that we need to move to a Global Formulary Approach. This is at the center of Pillar 1 of the BEPS 2.0 digital taxation debate.
These challenges are not limited to the CIT. They also apply to:

- VAT although we seem more successful in adapting our VAT rules than our CIT rules, and implementing a destination approach that recognizes the importance of markets to value creation, and that consumption is a less mobile factor than capital.
- And there are also challenges to the way we tax individuals, particularly the HNWI, who have greater freedom in where to carry out their digital activities. This has led countries to put in place special regimes to attract such people.
- More generally digitalization challenges the concept of tax competition: what is harmful and what is acceptable in a digital environment and this will require updating the standards set by the EU code of conduct group.

New opportunities
What I find is missing from the EU Parliamentary debate is a focus on the opportunities opened up by digital technologies - AI, ML ,Data Mining , Blockchain and others - to transform (disrupt) the way EU tax administrations operate and interact with each other and non-EU administrations. The EC to its credit has tried to push this agenda but MS have been reluctant (e.g. on harmonized digital platforms for VAT). These technologies have the potential to reduce the tax gap, to reduce the compliance and administrative costs of taxation, to provide a level playing field between different sectors and between MNES and SMEs in such sectors (recent EU data suggests that 70% of SME are digitalizing and

governments need to keep up – as expectations of their digitalization will legitimately increase) and to improve the competitiveness of EU companies in global markets.
Countries like Estonia, Italy and Spain have shown what can be done but more can be achieved by a coordinated approach.
To me this would be a good topic for this Committee to take up and I would be pleased to receive more information.

2. What is at stake for the EU in the current debate on international tax rules?
Short answer is much! With COVID-19 magnifying inequities and inequalities between and among countries, politicians need to show that the cost of the current health and economic crisis are being fairly shared and in particular that MNE and HNWI are paying their "fair" share of taxes, especially when we enter the exit phase of the crisis which will see countries having to increase their taxes.
Governments already are under pressure to ensure that traditional bricks and mortar companies are not being disadvantaged by our tax rules (that reminds me of the debate at the turn of the 20th century on relative taxation of horses and cars! And we know who won that debate). Also recent data suggest that the problem with the GAFA is not so much that their Global tax burden is lower than that of traditional businesses but that the tax is paid in the US not in the countries where they operate. It's also important that EU MNE are not at a competitive disadvantage vis-a-vis MNE from third countries such as China and the US which is why a global consensus is important. The EU should take a lead in shaping a consensus that works for the EU but has sufficient support to stand the test of global support (which will give greatest certainty to taxpayers and governments).
This is why it's appropriate that the EU should continue to explore how any consensus can be implemented within the EU. And if there is not a global consensus the EU needs a plan B:

- Whether it's a harmonized DST (with 10 MS already having a DST this may be a challenge) perhaps alongside non-EU countries looking to the EU for leadership;
- Pushing forward on the CCBT (Maybe the G20 initiative could help this long stalled project to move forward).
- Or looking at minimum tax proposals, perhaps along the lines of the Ruding proposals.

At this stage it remains unclear whether there will be a consensus reached in July 2021 under the Italian G20 Presidency: The US position remains unclear at executive level, and as to what is possible in terms of getting legislation through Congress, all of which may take more than six months. Many LDCs remain hesitant on the current proposals. There are still many technical issues to resolve, and even when resolved a full implementation will take 3-5 years, during which businesses will have to live with the complexity of the current proposals.

3. What criteria should this committee use to judge any outcome?
Listening to the debate over the last 6 months I sometimes get the impression that the only criteria to evaluate the outcome is whether there is a global consensus: consensus at any price!
I don't deny that a global consensus is desirable but the EU must also reflect now on what criteria it should use to judge the substance of any agreement.

Here are 5 suggestions:

1. Do we have a “real” consensus with all the major players not just signing onto the outcome but with a strong commitment to sign on to the resultant treaty and implement it in a consistent, predicable and fair manner? And do all countries have the capacity to do this? Will the pressure to get a global consensus lead to outcomes which paper over disagreements?
2. What are the generally accepted tax principles that underlie the agreement, particularly under Pillar 1? This is important since it can guide the courts when they have to resolve cross border disputes and also agreement on principles makes it easier to apply or even adapt the rules as new forms of business models emerge.
3. What is the impact on the competitiveness of EU MNEs (and SMEs, a group often forgotten in this debate) vis-a-vis those of third countries. And here countries should ask not just what is the short run impact but how will these rules apply as EU economies transform over the next decade (will they for example help Europe develop its own digital champions and take forward its ambitious digital agenda?
4. Is the resulting reallocation of corporate tax revenues PERCEIVED as being fair, including by the wider citizenry? How do they compare to the yield from DST, over time? Are there ways to achieve this fairness by means of redesigning the VAT which is less distorting than the CIT?
5. Are effective mechanisms in place to resolve the tsunami of cross border tax disputes that can be expected during the transitional period (3-5 years) before the new system beds down? What sort of dispute resolution system is achievable globally, given the hesitance of developing countries towards arbitration? Here there are lessons to be learnt from the EU Arbitration Directive.

I suggest that all of these conditions must be met if we are to have a durable set of global rules that will not be challenged over the coming decades and if countries are to be persuaded to avoid unilateral measures. The EU has a special opportunity to show leadership here and to help shape the rules for decades to come in ways which enhance international tax cooperation.