# Consultation on taxation of the digital economy

## Opinion no. 2013-3 of the French Digital Council

September 2013

# Introduction

Following the submission of the report on the taxation of the digital economy, issued by Nicolas Colin and Pierre Collin on 18 January 2013, the Minister for the Economy and Finance, the Minister for Industrial Renewal, the Minister for the Budget, and the Minister for Small and Medium-Sized Enterprises, Innovation and the Digital Economy asked the French Digital Council, an independent consultative committee, to organise an open consultation on taxation of the digital economy. After some preliminary work, this consultation was held from April to June 2013 by a working group comprising 14 Council members. Three group sessions were then organised and included numerous non-Council stakeholders who discussed the various taxation and policy proposals put forward as part of the public debate on the subject. These sessions were extremely rewarding in terms of the diversity of participants – business federations, economists, lawyers, start-ups, SMEs and government entities – as well as the methodology used and the proposals made.

Based on the work carried out by the French Digital Council's Taxation Policy Sections, chaired by Godefroy Beauvallet, Vice-President, including Benoît Thieulin, President of the French Digital Council, Tariq Krim, Vice-President, Ludovic Blecher, Nathalie Bloch-Pujo, Virginia Cruz, Stéphane Distinguin, Marie Ekeland, Virginie Fauvel, Lara Rouyrès, Cécile Russeil, Nathalie Sonnac, Bernard Stiegler and Marc Tessier, members of the Council, Jean-Baptiste Soufron, Secretary General, Yann Bonnet, Rapporteur General, Mathilde Bras, Assistant to the Rapporteur, the Council has issued its opinion on taxation of the digital economy to provide the government with guidelines that can be used in the decision-making process.

The Council's opinion focuses on non-sector-specific taxes as applied to the digital transformation (corporation tax, value added tax, tax incentives for the use of personal data, etc.). By issuing its opinion, the Council aims to offer solutions that are pragmatic and can be implemented quickly, and that will enable France to play a leading role in international negotiations and further the underlying economic debate. In doing so, the Council in no way wishes to take a stance on how best to support those sectors of the economy (culture, the press, etc.) that are currently undergoing a paradigm change as a result of the aforementioned digital transformation.

In addition, the Council is publishing a report summarising the contributions made by the relevant stakeholders, particularly regarding the feasibility of the taxes proposed by various players during the consultation and their suggestions for measures that can be taken at international, European and national level in the short and medium term.

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**Whereas,**

**The digital transformation must be a national strategic priority for France and should be speeded up and supported**. It would be both unrealistic and economically devastating to fight against this trend by introducing a unilateral "digital tax". France should make it an industrial goal to turn the digital economy into a sustainable growth driver. To this end, any plans to introduce new taxes must be assessed in relation to the competitiveness of emerging players. The digital economy in France is still a work in progress; factoring in the need to reconcile its economic potential with France's international position is a must.

This in no way means that those involved in the digital transformation cannot make a contribution to the collective tax effort. The idea is to contribute to discussions on the development of the digital economy and thus ensure that this sector comes to embody, perpetuate and rejuvenate our country's democratic, cultural and social values. This is a key moment in time, as the digital economy is currently the main driving force behind changes to society, business model transformations and government modernisation.

Taxation is at the heart of democracy. Yet, there is now a cross-sector trend for implementing aggressive tax planning practices. These practices are even more popular among recently-created, global digital companies that are highly agile when it comes to international trade. Issues arise when companies are tempted to indulge in unfair practices, bypassing intellectual property rights and taking advantage of regulatory loopholes, transfer pricing, fragmented governance, and ambiguities in international tax law drawn up before Internet existed and revolutionised trade, loopholes in competition law and the strong disruptive potential of digital technologies.

The goal is therefore to prevent dominant players from indulging in abusive practices, i.e. by using their tax planning abilities and their globalised profiles to create tax advantages for themselves, benefit from double exemption schemes and capture market share at the expense of local players. The widespread nature of these practices is behind governments' fears of base erosion and represents a long-term threat to the stability of public revenues in numerous countries.

In June 2012, the OECD was asked by the G20 to overhaul the international taxation framework. The OECD is a key player behind this modernisation drive. It has already made several proposals that have yet to be implemented and which depend on governments' involvement to rapidly reach an agreement. Since 2008, the European Union has been working on indirect taxation issues (VAT that will apply in 2015 and charge businesses that sell electronic services to consumers in the Member State where the customer belongs), while the European Commission has been looking at providing companies with a consolidated corporate tax base for their EU-wide activities since March 2011 (Common Consolidated Corporate Tax Base - CCCTB). These are key developments and France must work closely alongside its partners to identify priorities and establish a fairer tax system for the future.

Therefore, governments must avoid negotiating taxation rules for companies on a case-by-case basis. Priority should be given to concerted and coordinated initiatives between governments to ensure that the measures taken are effective and sustainable. The intrinsically international nature of the challenges faced means that the focus must be placed on international negotiations on non-sector-specific taxes (VAT, corporation tax); this implies not introducing national taxes at this stage that could undermine France's position in these talks and which would put at a disadvantage those that are less able to get round these taxes.

More specifically, and although a real step forward in discussions on taxation of the digital economy, introducing a "predator pays" taxation principle in relation to the collection and use of personal data (the so-called "Colin-Collin" tax) would only help France's position in international tax negotiations if it were implemented on a coordinated and multilateral basis. More broadly, as they currently stand, other proposals for taxes on online advertising, e commerce, bandwidth use and connected devices, which were pushed during the consultation, do not allow the fundamentally global nature of the relevant value chains to be factored in. They could have harmful tax ramifications for French businesses and consumers.

As for sector-specific taxes geared towards buttressing certain policies, such as aid to the written media and support for cultural industries, some of which do not lend themselves to dematerialisation or changes to taxpayers' business models, the examination of suggestions for changes currently on the table has revealed major problems with feasibility. Concretely, this means that not all the loss of value caused by digital transformation would be redressed (value chain distortion, loss of control over content flow, etc.).

Lastly, to adapt a large number of concepts to the digital transformation, should governments look beyond taxation and also draw on the resources offered by competition law, consumer law, privacy law or even intellectual property law. France can play a major role in redefining these concepts and should make itself heard as the world at large is now aware that urgent action needs to be taken.

The French Digital Council has the following opinion:

## 1. As regards the necessity for France to drive talks on overhauling the international taxation framework, the Council recommends:

● Bolstering its scope for action and ability to table proposals at multilateral level within the EU and OECD. This would enable France to uphold its interests and actively tackle tax base erosion:

> Work conducted in France, especially by Nicolas Colin and Pierre Collin on multi-sided market concepts and the importance of data in value creation, provides an excellent starting point for the "digital adaptation" of current international legal and tax concepts. The goal should be to reshape the territoriality of tax bases (value creation and profits) to better assess transfer pricing policies applied by businesses and the commercial value of services provided in exchange for the provision of data.

> For these topics France has internationally-renowned private and public sector economists, tax and legal specialists. To enrich academic and political discussions, we should leverage this asset by conducting comprehensive reviews, impact studies and simulations.

> As a priority for digital transformation, the Council believes that the following should be explored:

- The consequences of many markets having become two-sided markets where one side involves an exchange of "data for services" between users and the digital operator. A thorough examination of value creation needs to include the commercial aspects of exchanges which are apparently free of charge if only one side of the market is looked at.
- Defining "digital footprints" as "key collective resources" following on from the non-transferability of personal data.

> The relevant public academic organisations and research laboratories should be tasked with conducting studies on these topics within eighteen months in order to enable France to raise these issues during ongoing international talks

● Starting an infra-European tax initiative steered by France and its most sensitive partners to this topic, drawing on tangible provisions pinpointed during international talks to:

> Decide on common tax measures to be implemented at the same time by the countries involved in the initiative

> Conduct simulations and feasibility studies in several countries using the economic and operational data provided by businesses which may be liable for the taxes. Stakeholders' readiness to take part in discussions could be a gauge of their determination to be involved in overhauling the international tax system in a comprehensive way.
> Implement a coordinated approach in the form of a treaty, a formal enhanced cooperation process or an informal process for parallel legislation, using these simulations and studies which could be conducted rapidly
> Enact these new measures into French tax law and include a reciprocity clause (as for the "Tobin" tax on financial transactions). This would send a strong message to businesses which are uncooperative as regard taxes that their leeway is shrinking.

● Taking action against "conduit countries" which hamper international tax cohesion and promote tax havens. First and foremost, at EU level, this would involve bringing pressure to bear on Member States which foster aggressive tax practices, particularly low-tax countries which carry out dumping on indirect taxes and intellectual property revenue in the Single Market. To this end, the European Commission could be tasked with assessing the cost of the "non-cooperative tax expenditure" of Member States so that they could be factored into EU budget talks.

## 2. As regards the urgent need to restore transparency between governments, businesses and users through cooperation and control initiatives, *the Council:*

- Advises, on the basis of established law, taking action to monitor tax planning practices, looking first at their lawfulness through tightened controls. Fast and effective action could be taken in the short term alongside more long-term international talks.

- Recommends, at both international and European level:

> The imminent introduction of a database along the lines suggested by the OECD. This would mean that businesses would have to disclose their operations in every country and explain their behaviour and that of their subsidiaries, as well as providing detailed information of their relations with tax havens.

> Unrestricted, shared availability of this data enabling the modelling of labels and international rankings of cooperative and non-cooperative businesses. This would provide indicators on transparency and the responsibility of businesses, impacting on their image and reputation. These labels could be used as selection criteria for public procurement procedures and a rating agency could be set up.

> The introduction of a multi-national auditing task force that would observe best practices, encourage information exchange between tax authorities and step up mutual auditing and sanction procedures.

> Vigilance on the part of the government, and above all, the European Commission, with respect to stakeholders affected by the 2015 VAT reform, which may result in certain firms moving their tax residence outside of the European Union. To curb this risk, it is important to ensure that all countries comply with the agreed-upon timetable.

- Recommends, at national level, that tax and regulatory authorities focus their efforts on auditing non-cooperative businesses and/or those likely to abuse their dominant position:

> Adopting legal and organisational provisions to bolster the effectiveness, proportionality and cost-efficiency of tax audits, specifically when the administration audits firms that benefit from tax planning practices, and to strengthen relations between the private sector and the administration. These provisions include the possible introduction of a tax representative, heightened reporting obligations,

traceability of transactions outside of Europe, and an increase in the number of staff dealing with these tasks. In such a fluid environment, it is important that there be cooperation between auditors (whose prerogatives should not be questioned) and those being audited (whose rights must also be fully respected).

> Non-tax instruments should also be employed. Competition regulators, for example, should be involved more frequently so that fundamental concepts such as platform neutrality – as advocated by the Council in its opinion no. 2013-1 of March 2013 – can be taken into account.

> Finally, the basic principles of intellectual property should be reassessed in light of changing practices in terms of transfer pricing, collection of personal data and database consolidation, client databases, source codes, etc. It is vital that the arm's length principle be clearly incorporated into French tax law in order to best determine the value created by intangible asset transfers, as recommended in the report issued by the Inspection Générale des Finances in June 2013.

## *3. As regards the risks involved in immediately adopting national taxation of the digital economy, and the need to maintain the competitiveness of France's digital sector, the Council:*

- Believes that the introduction of new domestic taxes specifically aimed at the digital sector will in no way contribute to the goal of rebalancing the tax treatment of businesses with headquarters or a permanent establishment in France compared with those adopting aggressive tax planning practices.

- Recommends – without prejudice to the continued development of sector-specific schemes – that decisions in this area should take into account the fact that France's choices are signals to its international counterparts in broader negotiations. Without excluding adaptations, particularly in the area of jurisprudence, this calls for, at the very least, caution in terms of introducing new sector-specific taxes pending progress in these negotiations.

- Discourages the immediate and unilateral implementation of the various proposals pushed during the consultation:

> These measures are aimed at specific business models and can be circumvented. They may impede the competitiveness of French digital activities, and may appear to run counter to the principles of stability, fairness and neutrality of tax policy.

> These measures would hamper France's ability to win over its partners and would damage the country's tax attractiveness by giving businesses and investors the impression that the digital economy is a sector-specific issue and not a national priority.

- Emphasises the need for in-depth impact studies and simulations to be able to assess the long-term feasibility and the effective return (the balance between revenues and operating costs) of possible tax measures. These should be carried out prior to any changes in sector-specific taxation and measures involving cross-subsidies between digital economy stakeholders and those benefitting from support (culture, written media, etc.).

## *4. As regards the need to roll out a digital industrial strategy at European level to speed up the digital transformation of both businesses and the public sector,* the Council recommends:

- Actively promoting digital technologies as a factor in industrial productivity. To this end, public authorities in both France and Europe should both show their support for the digital economy through actions such as tax incentives for developing businesses' digital activities, for education and vocational training, and for speeding up the digital transition of public stakeholders, as well as through balanced support for the transformation of existing players and the emergence of new, cutting-edge players.
- Rapidly implementing the concluding proposals of the Entrepreneurship Conference in France (Assises de l'Entrepreneuriat) and promote them at European level. Their successful deployment will involve the redefinition of key concepts to adapt them to digital activities. For example, it is vital to expand the concept of innovation beyond mere technological R&D activities and include innovations in services and design in order to better support digital entrepreneurs, encourage them to develop new tools, and foster employment in this sector.
- Deploying, at the initiative of France and its partners, a European-level digital industrial policy to nurture the digital ecosystem, by adapting these measures specifically to companies' level of development, and by supporting their growth so that our current startups become high-powered medium-sized companies in the future.

All of these courses of action have their place in the position that France should advocate at the upcoming European Digital Council in October 2013, with an eye to sketching out European governance of the digital economy over the next five years. Digital governance should also be clarified at domestic level so that the relevant authorities and government departments coordinate their efforts in the area of tax, economic and industrial policies, thereby ensuring that the digital transformation benefits both our economies and our society.

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