MOORE STEPHENS

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Dear Sir or Madam

RESPONSE FROM MOORE STEPHENS INTERNATIONAL LIMITED ("MSIL", "WE") TO THE OECD CONSULTATION DOCUMENT "ADDRESSING THE TAX CHALLENGES OF THE DIGITALISATION OF THE ECONOMY"

MSIL appreciates the work that has been undertaken by the OECD in this area to date and welcomes the opportunity to provide its comments and views on the complex area presented. In doing so, we appreciate that the proposals made in the discussion draft are still at a policy design phase, and therefore discuss broad principles.

General remarks

In October 2015, the OECD Task Force on the Digital Economy concluded that it is "neither appropriate nor feasible" to ring-fence the digital economy, recognising that the overall global economy is becoming increasingly digitalised. As of today, the digital economy has thoroughly penetrated the overall economy to the extent that it is neither desirable nor feasible for the digital economy to be ring-fenced from the latter. Simply put, the old and established tax and transfer pricing rules are no longer fully appropriate in a modern digitalised economy. It is, however, an area of tax and transfer pricing that is complex and not without controversy or differing views and opinions. These specifically include the allocation of taxing rights and the quantification of the income subject to tax in a particular jurisdiction

Therefore, due care needs to be taken to avoid creating a separate set of tax rules for digital businesses that would require policy makers, tax administrations and taxpayers to make arbitrary distinctions about which businesses are digital businesses and which are not.

Section 2 Revised profit allocation and nexus rules

General remarks

In Section 2, the document suggests a new profit (loss) allocation mechanism that reallocates an MNE's residual profits (loss) to the user or market jurisdiction. This modification of the current profit-allocation mechanism and nexus rules may potentially give rise to double taxation between jurisdictions. Any intended split of income must therefore remain consistent with the objective of aligning taxable profits with value creation – a concept we fully support.

Section 2.4 Question 1

In our view the approaches described under the three proposals should be analysed simultaneously, based on the appropriate economic value-chain analysis (discussed further in our answer to Question 3 below).

All three proposals should follow an approach based on a proper analysis of the economic value chain. We also believe that it would be useful for MNEs to apply each approach as a means of testing their allocation of profits to the individual jurisdictions they operate in by reference to a simplified cashflow-based method applicable to their revenue streams in each jurisdiction (including revenues from derivatives, block chains and cash-based or capital-based derivatives).

Section 2.4 Question 2

See also our answer to Question 1.

We should also like to take this opportunity to consider the issue from an African perspective, to provide a viewpoint other than those of the most highly developed countries.

Historically within Africa the use of digital business development and marketing was not applied to the same extent as was the case in more developed countries. However, with the increased availability of the internet, wi-fi etc and the fact that mobile phones are used by the majority of the population in a lot of African countries, on-line marketing and sales have increased significantly, challenging the traditional premises-based marketing and sales. As a result, African jurisdictions are increasingly being affected by digitalisation, especially since a number of MNEs would regard this as a less risky method of distributing their goods and services to African customers and clients. This is typically the case in telecommunications; the retail industry, for example clothing; the gaming industry in some of the more developed African countries; and the IT industry, including hardware and software sales, but in the near future, suppliers will be able to market and distribute basically any product with no or very little physical presence and activity in the buyer jurisdiction.

Although potentially difficult to administer in Africa, with limited resources to do so, a residual-profit split would help to level the playing field to an extent, provided that the criteria for the calculation and allocation of the residual profit were clearly set out. The bigger problem is obtaining the buy-in from the African revenue authorities in terms of correctly applying these rules, ensuring certainty for MNEs carrying out transactions in these countries on a digital basis. Also, at this stage, very few African jurisdictions have signed the BEPS agreement, and, with a comparative paucity of double tax agreements, the enforcement of new profit-allocation measures would be challenging. The position in Africa is, however, changing and if fairer profit-allocation rules were to be introduced, which would benefit African jurisdictions, it would be in their interest to adopt and apply such rules.

Section 2.4 Question 3

Aligning taxable profits with value creation should be the guiding principle whichever proposal is finally adopted. Therefore, a residual-profit split in combination with proper economic substance delivered using comprehensive value-chain analysis should form the basis for selecting the appropriate approach, not only towards digitalised structures but all transfer-pricing structures in play.

Such a basis would on the one hand answer the questions of where the significant economic presence, user participation and marketing intangibles are located, and what value drivers can be attributed to these.

At the same time, an accurately designed residual-profit split based on the value chain would need to comply with an MNE’s actual business model and modus operandi.

The *user-participation proposal*, while superficially attractive, focuses on the value created by highly digitalised businesses that have developed an active user base and are able to solicit data and content contributions from those users. In its favour is that it rests on the value-creation principle. However, assigning such value solely to the user base dismisses the importance of the platform or vehicle that curates the user data. The collection of raw data alone is becoming a ubiquitous activity and while the raw data is certainly valuable, the ability/platform to process, digest, curate, and create relevant reports of the user data is equally valuable. Thus, profits should also be assigned to the activities of the MNE taxpayer that owns this process, which is what the *marketing-intangibles proposal* attempts to accomplish.

From a purely practical point of view, how would one measure the value added and quantify the engagement, interaction and contributions of users? If, say, by the number of clicks on a platform, how to guard against manipulation by bots and suchlike? On the other hand, if a crude measure such as relative population size were to be adopted, smaller countries and jurisdictions would be disadvantaged.

Ultimately, a social media platform is only an infrastructure for digitalisation. The owner’s business model is based on advertising. Companies pay for advertising because there is a customer base in a jurisdiction that they can reach through this medium. So the core question is, who creates the customer base? We are not convinced that this question can be answered by conventional transfer-pricing rules. Perhaps jurisdictions should have the right but not the obligation to ask the business exploiting the network platform in their territory to pay a user tax, just as some countries levy tolls for the use of their motorways while others do not. Under this proposal, the payers of the user tax would re-invoice the cost to advertisers. This seems a simple and logical solution.

The *marketing-intangibles proposal* preserves key elements of the arm's length principle while acknowledging the value of user participation in a digitalised economy. As with the user-participation proposal, it too is founded on value creation. In our view, however, it is the only proposal that preserves the integrity and foundation of the arm's length principle, which is still a critical basis for structuring intercompany transactions. The allocation of non-routine or residual income between marketing intangibles and other income-producing factors could be determined using traditional transfer-pricing principles. Once the marketing-intangible profit is defined, then it should be further split on the basis of value creation between the different functions of the exploitation of data, data collection, data processing and making the data available. The next step, being the jurisdictional split, can be accomplished using factors such as sales by region so as not overly to complicate the application of this proposal. The marketing-intangibles proposal can address the concerns of certain jurisdictions, that, despite BEPS Actions 8-10, MNEs are still able to shift a disproportionate amount of profits to low-tax jurisdictions based on contractual allocations.

Under the *significant economic presence proposal*, in contrast, taxable presence would arise on the basis of several factors, and the allocation of profit to a 'significant economic presence' could be based on a fractional apportionment method based on sales, assets, employees or users, if users contribute meaningfully to the value-creation process. However, the proposal also contemplates the possible imposition of a withholding tax as a collection mechanism and enforcement tool. This proposal essentially abandons the concept of the arm's length principle by imposing a tax on MNEs without a link to value creation in the jurisdiction in which the tax is levied. Adopting such a measure would require new models for income attribution, which should then be applied to all businesses, not just those involved in the digital economy. The creation of an economic-nexus standard for digital businesses based purely on arbitrary apportionment factors, rather than the activities of the MNE taxpayer, would represent a fundamental shift with potentially adverse ramifications.

Finally, it is especially important from the perspective of less developed jurisdictions that there should be the least amount of complexity in order to ensure certainty from both a revenue authority and multinational taxpayer perspective, otherwise new profit-allocation rules may be abused and could also threaten MNE disinvestment from those jurisdictions. The allocation-enforcement vehicles, for example DTAs or transfer-pricing rules, should also be sufficiently established in these jurisdictions.

Section 2.4 Question 4

As the document recognises, what is proposed is a reform of a complex area of the taxation and transfer-pricing rules. The proposals will be subject to significant jurisdictional, interpretative and implementation issues, controversy, disputes and potential double taxation.

Hence these proposals require, as the consultation acknowledges, "strong dispute prevention and resolution components" (para. 84).

We further support the view that "the objective of any potential dispute prevention and resolution features would be to ensure a consistent application of the proposals across tax administrations in multiple participating jurisdictions".

The concept of joint audit programmes and the ICAP pilot have some merit, as does the utilisation of advance pricing agreements (APAs). However, it is our opinion that such an approach may be less useful to SMEs due to the cost and time involved in such procedures. Therefore, we submit that specific, simple and additional measures should be considered that would increase and broaden participation of SMEs in dispute prevention and resolution procedures.

We support the use of appropriate data points and believe that if appropriately set and administered they would also significantly assist in the effective administration of the proposals. We understand this to mean that a broad risk-based approach to the relevant tax and transfer pricing issues would be adopted, based on comparative data and that some form of simplified or safe-harbour mechanism may be proposed. If this is the intention of the proposal, we support such a proposal. If not, we would recommend that such measures be considered. The relevant data, as envisaged, can be acquired locally in relevant jurisdictions from tax and accounting records but also potentially from CbC report filings.

Again, this latter source of data would only be relevant to significant global entities and therefore a significant number of companies (including SMEs) would not be included in this potential data source.

SMEs will neither have the time nor the ability to pay for some of the suggested dispute-resolution mechanisms, e.g. APAs. Further less complex, less costly and less time-consuming measures need to be considered. Accordingly, we suggest that there is both a need and scope for both simplified documentation and safe harbours in this complex tax and transfer pricing area.

Section 3 Global anti-base erosion proposal

Section 3.6 Question 1

The *income-inclusion rule* appears to be a refinement of the CFC rules adopted in many jurisdictions and also seems to build on the recent GILTI (global intangible low-taxed income) rules in the United States. Similarly, the proposed *tax on base-eroding payments* appears similar to the United Kingdom's hybrid-mismatch rules.

We do not at this stage wish to comment further on these, except to say that an OECD-wide approach, with due regard to the peculiarities of particular member states' tax systems, would be preferable to the current situation in which individual jurisdictions adopt similar but potentially overlapping and conflicting variants of their own in a piecemeal fashion. The European Union has taken steps in this direction in its recent "ATAD" (Directive (EU) 2016/1164) which, inter alia, required all EU Member States to enact (where necessary) CFC rules conforming to certain basic criteria.

At the same time, as other commentators have observed, there would be enormous issues in developing an international framework that could overlay existing and prospective national legislation and existing BEPS measures without adding a further, possibly damaging storey to the edifice.

At this stage, therefore, we wish to withhold judgement on the desirability and feasibility of this proposal.

Concluding remarks

We are grateful for the opportunity to provide our comments and would be pleased to discuss or clarify our response. In that event please contact any of the persons listed in the table overleaf.

Yours faithfully

On behalf of MSIL

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