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Public consultation on the possible solutions to the tax challenges of digitalisation

Dear Sir or Madam,

Thank you for the opportunity to comment on the consultation document “Addressing the Tax Challenges of the Digitalisation of the Economy”. The German Retail Federation (HDE - Handelsverband Deutschland) is the umbrella organisation of the German retail sector. In Germany, approx. 300,000 retail companies with 410,000 outlets and over three million employees generate a combined turnover of over 500 billion euros annually.

Below, we provide you our comments on the consultation document.

Comments to questions in section 2.4.

Question 1

“What is your general view on those proposals? In answering this question please consider the objectives, policy rationale, and economic and behavioural implications.”

Comment:

To further competition, businesses need a level playing field, which includes taxation. Extreme low taxation of cross-border-online sellers may place local brick and mortar retailers in market countries at a competitive disadvantage. To achieve a level playing field, it would be irrelevant in which jurisdiction income is taxed as long as it is taxed once and sufficiently. However, we acknowledge that digitalization is perceived to present challenges relating to the question of how taxing rights on income should be allocated among countries. A logical response may be to change current allocation rules. However, any change of the allocation rules should not lead to an increase of

double taxation risks or administrative burdens or be at the expense of legal certainty and the coherence of transfer-pricing rules.

Question 2

“To what extent do you think that businesses are able, as a result of the digitalisation of the economy, to have an active presence or participation in that jurisdiction that is not recognised by the current profit allocation and nexus rules?”

In answering this question, please consider:

- i) To what types of businesses do you think this is applicable, and how might that assessment change over time?
- ii) What are the merits of using a residual profit split method, a fractional apportionment method, or other method to allocate income in respect of such activities?”

Comment:

Ad i)

As a result of the digitisation of the economy, reaching customers in remote markets where the business has no or little physical presence is already well advanced today. Traditional business models continue to evolve and adapt to the digital economy. Brick and mortar retailing is supplemented or even replaced by online marketplaces and the exchange of customers among themselves as well as with sellers takes place increasingly online. The demand for online markets is growing and it is expected that the supply and diversity of services will increase. The establishment of online markets will draw the attention of the customers to the digital economy, so that value will be increasingly created online.

Ad ii)

The Discussion Draft proposes in para. 24 the parallel use of two different profit allocation mechanisms. The "non-routine profit" is determined by traditional transfer-pricing methods and the residual profit is then assigned to market jurisdictions by means of a formula.

Thus, the profit is allocated using two fundamentally different approaches. We expect this would lead to friction, additional administrative burden and risk of double or non-taxation. Views on what constitutes a value driver of a business model (i.e. routine or non-routine) could differ between jurisdictions. For example, in the case of online marketplaces, views could diverge as to whether the logistics function in a given jurisdiction is to be regarded as a value driver which should attract a portion of the residual profit. These types of disagreement between jurisdictions would have to be covered by future mutual agreement procedures, which would become even more cost and time-consuming than at present.

Question 3

“What would be the most important design considerations in developing new profit allocation and nexus rules consistent with the proposals described above, including with respect to scope, thresholds, the treatment of losses, and the factors to be used in connection with profit allocation methods?”

Comment:

In our view, the following aspects are the most important design considerations:

- In order to alleviate complexity, the scope should be limited to certain clearly pre-defined activities.
- Allocation rules should use a clear-cut allocation metric.
- De-minimis thresholds should be used in order to leave SMEs out of scope.
- Residual profit should be computed under the income computation rules of the jurisdiction in which the entity realizing the residual profit is resident.
- Residual losses should be subject to allocation by the same logic and principles as for profits.
- Double taxation should be avoided, binding arbitration and mutual agreement procedures as a prerequisite
- Tax compliance (certainty, process, declaration, tax payments, etc.) should be simple and not overly burdensome.

Question 4

“What could be the best approaches to reduce complexity, ensure early tax certainty and to avoid or resolve multi-jurisdictional disputes?”

Comment:

The following approaches should be observed:

- Rules for determining the residual income and its allocation to the various jurisdictions must be simple and clear cut.
- There should be reduced documentation requirements. We recommend the establishment of a fixed set of allocation keys that need no further justification. For example, if the residual profit is (re-) allocated based on external turnover attributable to the source country as one of the predefined allocation keys, there should be no requirement to specifically document why turnover is appropriate in the situation at hand.
- Businesses must be able to rely on figures which are easily available in their records.

Comments to questions in section 3.6.

Question 1

“What is your general view on this proposal? In answering this question please consider the objectives, policy rationales, and economic and behavioural implications of the proposal. “

Comment:

The proposals avoid the practical complexity and risks of double taxation inherent in the proposals directed at changing nexus and transfer-pricing rules in section 2. However, they carry their own potential to create complexity. In addition, in the light of the CFC-rule recommendations in BEPS Action 3 it seems difficult to justify an income inclusion rule that applies in addition to current CFC rules. The additional income inclusion is directed not only at artificial arrangements but at any foreign low-taxed income, be it from legitimate activities or from artificial and tax evasive arrangements. Such a rule could only be justified if the low taxation threshold is agreed by the members of the Inclusive Framework and is considerably lower than for the application of CFC rules.

Question 2

“What would be the most important design considerations in developing an inclusion rule and a tax on base eroding payments? In your response please comment separately on the undertaxed payments and subject to tax proposals and also cover practical, administrative and compliance issues.”

Comment

The most important design considerations should be:

- The proposals require that foreign derived income is tested against a minimum taxation rate. In the case of the income inclusion rule, it is the shareholder who has to compute income of its foreign subsidiary in order to determine whether the subsidiary is taxed sufficiently under domestic law of the parent jurisdiction. This may be a very cumbersome exercise. If the shareholder lacks sufficient control over the foreign subsidiary - as often may the case with minority shareholders – and therefore has no access to the records of the foreign entity, it may even be impossible. The income inclusion rule should only apply to situations where the shareholder has substantial control over the foreign entity which enables access to the records of the latter.
- Similarly, under the undertaxed payments rule and subject to tax rule, the entity making the payments to a foreign entity has to rely on information on how these payments are taxed at the level of the foreign entity. This may be impossible if the foreign entity is not a related party.

- No double taxation: Under the income inclusion rule, foreign tax must be fully creditable in the parent jurisdiction. A distribution of profits that were subject to a tax back under the income inclusion rule must be fully tax free.

Question 3

“What, if any, scope limitations should be considered in connection with the proposal set out above?”

- The income inclusion rule should only apply to majority participations or PEs. Only foreign entities with a relevant income should be covered, i.e., there should be a de-minimis rule to relieve the shareholder from excessive administrative burden.
- The undertaxed payments rule and the subject to tax rule should only be applicable between related parties.
- There should be a de-minis exception for the undertaxed payments and subject to tax rule in order to leave SMEs out of scope.
- The various anti-base-erosion rules should be carefully co-ordinated so that economic double taxation and excessive compliance burden is avoided.

Question 5

“What could be the best approaches to reduce complexity, ensure early tax certainty and to avoid or resolve multi-jurisdictional disputes?”

The minimum taxation rate should be set so that the anti-base-erosion rules are triggered only in instances of serious low taxation. The minimum tax rate should be set at the OECD level. A white list of jurisdictions with sufficient taxation should be published by local tax administrations.

Under the income inclusion rule, to test the income of the foreign entity against the minimum taxation threshold, the income is to be computed under the rules of the parent jurisdictions. This is administratively burdensome. In addition, legitimate privileges granted by the foreign jurisdiction in relation to the tax base (e.g. special depreciation rules) may be by-passed. Therefore, the parent jurisdiction should publish a white list of jurisdictions whose tax base it recognizes so that the parent entity would be relieved from the task to compute the foreign tax base under the rules of the parent jurisdiction.

Allowing the parent company to use GAAP-based figures for purposes of the low taxation test should also be considered.

Yours sincerely

A handwritten signature in black ink that reads "Jochen Bohne". The signature is written in a cursive style with a large initial 'J' and a long, sweeping underline.

Jochen Bohne
Head of Tax Department