



## Commissioner Paolo Gentiloni

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### BILATERAL MEETINGS WITH TECH COMPANIES

**23-24 January 2020,  
World Economic Forum**

**TAXUD contribution on digital taxation**

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## KEY MESSAGES

- **A fair and effective taxation of the digitalised economy remains a top priority for the EU.** The international corporate tax framework is out of step with the realities of the modern economy.
- **Taxing rights are misaligned with the new realities of value creation** in today's increasingly digitalised and globalised world: companies can operate in a market without a taxable physical presence there and the role of user participation and data in the value creation is not recognised.
- **Digitalisation also contributes to the changing nature and the intensification of tax competition:** highly mobile assets (e.g. intangibles) are increasingly important and statutory corporate tax rates are in steady decline, fuelling the 'race to the bottom dynamic'.
- **These challenges are exacerbated in the EU** as both the misalignment of taxing rights and tax competition undermine the level playing field between businesses and distort the competition within the single market.
- **This situation is economically inefficient,** hinder the development of businesses and may hurt innovation, growth and welfare. The modernisation of our tax system is therefore necessary to fully seize the opportunities of the digital economy.
- **The Commission strongly believes that the best solution is a global one and supports the work done in the OECD.** We welcome the progress achieved so far at global level.

- **The alternative is not the status quo, but rather a further increase in unilateral measures**, increasing tax compliance costs and tax uncertainty for businesses, and leading to double taxation and disputes. Within the EU, it also risks the fragmentation of the single market, creating an imperative for us to find a solution.
- **It will be important that the outcome of the discussions effectively captures digital business models, and also avoids double taxation and additional complexity for businesses.**
- **The two pillars of the discussion are complementary as they address different issues** (Pillar 1 aims at realigning taxing rights with value creation while Pillar 2 aims at tackling aggressive tax planning and excessive tax competition). Countries will not drop their unilateral legislation if an agreement is not reached on either Pillar 1 or 2.
- **I would encourage the business community to continue engaging constructively** with the process to ensure its voices are heard.
- **My door is always open to discuss any of your concerns**, so we can make sure we strike the right balance between ensuring fair taxation and the need to support the digitalisation of our economies.

## DEFENSIVES

***The “Unified Approach” is a departure from the long-standing principles in direct taxation (“arm’s length principle”). Therefore, the “Unified Approach” should be only optional (“safe harbour”).***

[For background: The view that Pillar 1 should be optional (“safe harbour”) was suggested by the US in December. The draft Statement for endorsement by the Inclusive Framework at the end of January (N.B. this is still a confidential document) records the concerns that optionality would risk the project not meeting its policy objectives. Surprisingly the US, did not object to this statement in the draft, but may try to stop its adoption]

- It is a departure but there is consensus among the G20 that the current principles are no longer acceptable for the allocation of profit within multinational groups, especially when it comes to digitally intensive business models.
- A revised approach is needed to achieve a fairer allocation of profit based on where value is created. If this were optional it would undermine the whole purpose of the new initiative.

***The redistribution should happen only on the basis of the residence of the paying customers.***

- The market value of the highly digitalised businesses is directly linked to the number of their users, including users that make use of free services. These users do participate actively in the business models of those companies and undoubtedly bring value.
- If they were excluded, the scope of the rules would be much narrower and not reflect the policy goal of aligning taxation with value creation.

## BACKGROUND

### 1. Companies' positions on digital taxation

Apple and Google **have not directly replied** to the OECD's recent public consultations on reallocation of taxing rights (Pillar 1) nor (as well as Uber) on minimum effective taxation (Pillar 2). However, they are members of representative bodies, which have sent submissions. Booking.com and Uber have provided separate submissions.

The key points from the submissions are the following:

- **Avoiding any double taxation, limit the compliance burden and increase tax certainty**, e.g. by a one-stop-shop and strong dispute resolution mechanisms. At high level, we share these goals.
- **Removal of unilateral measures** such as Digital Service Taxes. We share the view that we should aim for a global agreement, as unilateral measures create fragmentation and distortions to the market.
- Making the reallocation of taxing rights optional. We are strongly against – such a prospect would defeat the purpose of the exercise.
- [Except for Uber] The MNEs should be allowed to choose how to **split their accounts** ("segment") between in-scope and out-of-scope activities. For the Commission, splitting the accounts on an arbitrary basis will create circumvention opportunities, uncertainty and tax disputes.
- **Exemption** from minimum effective taxation of taxation regimes that are seen as equivalent to proposed reforms, in **particular the U.S. regime of taxing foreign income**.
- Using the so-called "**worldwide**" rather than "**jurisdictional**" approach in minimum effective taxation, i.e. mixing profits from low and high tax jurisdictions in calculating the effective tax rate. We are strongly against this approach as it would undermine the policy objective.
- Consideration for special rules for **innovation** incentivising **tax reliefs** when calculating minimum effective taxation.
- The minimum effective taxation should apply to **all sectors** of the economy, but only to groups **above the threshold** of annual consolidated group revenues €750 million.

#### Apple specific

- While not directly related to the OECD digital taxation initiative, the Commission's state aid investigation into the tax structure of Apple showed significant misalignment between the allocation of Apple's non-US profits and the place of the value-creating activities.
- On 20 January, Apple chief executive Tim Cook said that the global tax system needs to be overhauled: "I think logically everybody knows it needs to be rehailed, I would certainly be the last person to say that the current system or the past system was the perfect system. I'm hopeful and optimistic that they (the Organization for Cooperation and Development) will

find something,” Cook said in Ireland after receiving an award, according to Reuters. “It’s very complex to know how to tax a multinational... We desperately want it to be fair,” Cook went on.

#### Google specific

- Google considers that the scope of the OECD project is still rather vague, especially with regard to which businesses would be covered and how to eliminate double taxation. We would also invite more clarity.
- The Alliance for Competitive Taxation (which Google Inc. is part of) wrote a rather critical letter to the Secretary of Treasury Mnuchin in September 2019, defending the current system (the so-called “arm’s length principle”) and questioning the need to change it.

#### Booking.com specific

- Booking.com considers that the basis for reallocation should be limited only to profits strictly linked to marketing intangibles. For the Commission, while conceptually that is closer to the policy goal, it is practically impossible to implement).
- They consider there are potential EU State aid issues with the application of a threshold of €750 million. For the Commission, State aid is an important consideration. However, we should not forget that the purpose of the mechanism is not to create new tax base, but only to redistribute the current tax base.
- Booking.com were part of the panel at the November 2019 OECD public consultation on the “Unified Approach”.

#### Uber specific

- For Uber, having 3 cumulative elements (Amounts A, B and C) to the “Unified approach” complicates the system, better to focus now only on the first element - Amount A. For the Commission, the amounts have different policy drivers and removing one of them would create a loophole.
- The Uber submission appeared overall quite constructive. Back in August 2019 Uber put out publicly a proposed mechanism for redistributing profits to market jurisdictions. TAXUD’s analysis at the time was overall positive. The first element of the OECD’s “Unified approach” (Amount A) is almost an exact replication of the Uber proposal.

## 2. Key figures on companies

The key figures provided below are from the consolidated financial statements of the whole MNE group. The key figures and their relevance are summarised below:

- Return on Sales/net margin (Operating income divided by Total net sales). If the figure is much higher than 10%, the MNE will have significant exposure to the distribution under the “Unified Approach”.
- Effective tax rate (Provision for income taxes divided by Income before provision for income taxes). That gives a rough idea whether at group level there is significant tax avoidance.
- Balance sheet total. Shows how “big” the company is from conservative accounting perspective, excluding intrinsic (unaccounted) intangibles.
- Market capitalisation. Shows how “big” the company is from the perspective of the financial markets, i.e. taking into account intrinsic (unaccounted) intangibles.

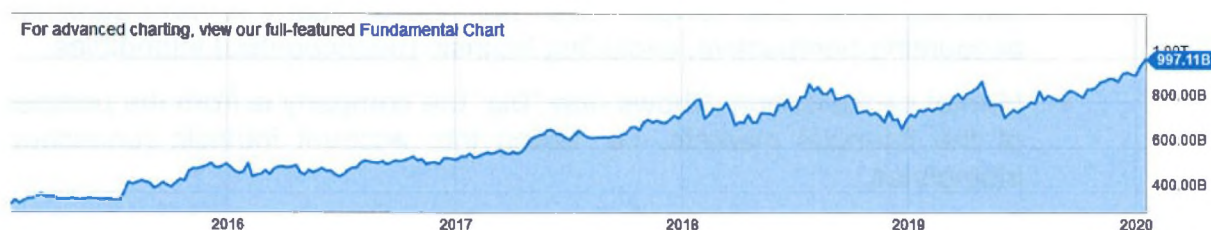
### Apple:

- Return on sales/net margin: 25%. Significant “Unified Approach” exposure. To be noted: the gross margin on “services” (e.g. the iTunes store) is 64%.
- Effective tax rate 15.9% (This is mostly tax due in the US, for EU profits it uses the Irish “Capital Allowances for Intangible Assets”)
- Amount of corporate taxation the company has paid worldwide: USD 10.4 billion
- Balance sheet total USD 338 billion
- Market capitalisation USD 1.37 trillion



### Google<sup>1</sup>:

- Return on sales/net margin: 20%. Significant “Unified Approach” exposure.
- Effective tax rate 11.9% (This is mostly tax due in the US, Google has used the Double Irish structure in the past. That expires in 2020. The new Google structure is unknown.)
- Amount of corporate taxation the company has paid worldwide: Alphabet (includes Google Inc.): USD 4.1 billion
- Balance sheet total USD 197 billion
- Market capitalisation USD 0.997 trillion



### Booking.com<sup>2</sup>:

- Return on sales/net margin: 37%. Significant “Unified Approach” exposure.
- Effective tax rate 17.3% (This is mostly tax due in the US. Booking.com uses the Dutch IP Box regime.)
- Amount of corporate taxation the company has paid worldwide: USD 837 million
- Balance sheet total USD 22 billion
- Market capitalisation USD 85 billion



<sup>1</sup> After the corporate restructuring in 2015, Google Inc. is part of Alphabet Inc. The result below is from Alphabet Inc.'s consolidated financial statements

<sup>2</sup> Booking.com is part of Booking Holdings Inc. and is only one of six popular primary brands.



### Uber:

- Return on sales/net margin: -27% (loss). No current exposure to the first element of the “Unified approach” (Amount A). Probably exposure to the second element of the “Unified approach” (Amount B).
- Effective tax rate 21.5% (Uber is on operating loss but has income from extraordinary items, so it has some minimum taxable profit)
- Amount of corporate taxation each company has paid worldwide: USD 283 million (this is only accrued tax, Uber is still using tax losses from previous years, e.g. for 2017 it had a tax effect USD -542 million due to losses)
- Balance sheet total USD 24 billion
- Market capitalisation USD 59 billion

For advanced charting, view our full-featured [Fundamental Chart](#)



### Facebook:

- Return on sales/net margin: Return on sales/net margin: 44.6%. Significant “Unified Approach” exposure. Highest of the ones researched so far.
- Effective tax rate 12.8% (This is mostly tax due in the US. The financial reports do not describe the Facebook tax structure, but other reports mention the use of Ireland for sheltering the intangibles. There are third-party publications that Facebook reported **USD 12.6 billion in revenue in Ireland** on which it paid **USD 30 million in taxes** in 2016. So, in Ireland the effective tax rate is only **0.2%.**)
- Amount of corporate taxation the company has paid worldwide: USD 3.2 billion
- Balance sheet total USD 97 billion
- Market capitalisation USD 630 billion

For advanced charting, view our full-featured [Fundamental Chart](#)



- Other relevant facts from Facebook's financial reports: 50% of the ad revenue comes from the US/Canada, but only 10% of the users (mostly non-paying) are in the US/Canada. That means that if the “Unified Approach” does not cover non-paying users, the reallocation will be much more modest.



### **3. Background on the negotiations at the OECD**

#### *Which are the main issues at stake?*

The international tax framework is out of step with the realities of the modern economy. Current corporate tax rules are misaligned with the new realities of value creation, and cannot prevent excessive tax competition between Member States and with international partners. These developments undermine the level playing field between businesses, threaten the revenues needed to fund the EU social model and risk creating unfair burden sharing between taxpayers. These considerations create a need for a deep modernisation of the EU business taxation environment.

Following the EU digital taxation proposals of March 2018, discussions on a reform of the international corporate tax framework have accelerated within the OECD Inclusive Framework (which comprises more than 130 countries), mandated by the G20. The G7 has also endorsed the discussions.

The nature of the international discussions has gone beyond focusing on the taxation of the digitalised economy to cover broader issues articulated around two broad pillars:

- **Pillar 1** aims at better aligning taxing rights with the new realities of value creation with today's increasingly digitalised and globalised economy by reallocating a share of multinationals' profits to market jurisdictions.
- **Pillar 2**, known as the "global anti-base erosion" or "GloBE" proposal would set a global minimum effective taxation of the profits of multinational companies, which would help to curb tax avoidance and put a floor to tax competition.

**The aim is to have a political agreement on a framework solution endorsed by the OECD Inclusive Framework for Pillar 1 at the end of January 2020 meeting and for Pillar 2 at the June 2020 meeting.** The technical discussions throughout the year on both Pillars will culminate with final consensus-based solution and the final report to be delivered by the end of 2020.

If there is an agreement, the Commission will, as guardian of the Treaties, have to ensure a smooth implementation that is compatible with our Union legal framework and the Single Market. In the absence of a global agreement by 2020, the Commission has expressed the need for the EU to act alone.

#### *What is the latest state of play?*

The **work on Pillar 1** (profit allocation) has clearly accelerated. A framework for a "unified approach" will be presented for agreement by the Inclusive Framework on 29 January. The unified approach is a synthesis of the contributions that the US, UK and G24 (including India) put on the table before the summer break. A public consultation meeting on the unified approach proposal was held in Paris on 21-22 November 2019. The business community seems to accept the idea that the creation of a new nexus rule is an inevitable way forward, but contests the changing of the rules for profit attribution and the new layer of complexity brought forward by the Unified approach.

**On Pillar 2** (Minimum Effective Taxation), the work is not as advanced, many design options remain on the table in the OECD and are discussed at the technical level. A public consultation on some design elements of Pillar 2 took place on 9 December. Some business stakeholders emphasised the potential level of complexity of the rules, double taxation, while other called for focusing the discussions on the objective of pillar 2. A more detailed public consultation to take place in March/April 2020.

On 3 December 2019, the **US secretary of the Treasury S. Mnuchin wrote a letter OECD Secretary General A. Gurría putting into question the Pillar 1**. Instead, the US suggests making Pillar 1 a safe harbour regime i.e. optional for companies. The G7 decided on 7 December to push for proceeding with the unified approach on Pillar 1 in the OECD, and consider the U.S. suggestion as an implementation issue to be addressed at later stage.

At the end of December 2019, **the OECD circulated** an outline of an agreement on Pillar 1 issues, a progress note on Pillar 2 and a statement by the Inclusive Framework on the Two-Pillar Approach. These documents are for discussion and approval at **the meeting of the Inclusive Framework on 29-30 January 2020**.



