



July 26, 2018

VIA EMAIL:

Commissioner Pierre Moscovici  
Economic and Financial Affairs,  
Taxation and Customs  
European Commission  
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**Re: Digital Directives – Digital Services Tax and Significant Digital Presence**

Dear Commissioner Moscovici,

USCIB is writing in response to the issuance of two directives – 1) the Directive on the common system of a digital services tax (“DST”) on revenues resulting from the provision of certain digital services (“Interim DST Directive” or “DST Directive”) and 2) the Directive laying down rules relating to the corporate taxation of a significant digital presence (“Permanent SDP Directive” or “SDP Directive”). For the reasons explained below, USCIB believes that the directives should not be adopted. The draft directives reflect a lack of understanding of current and evolving business models and would distort the allocation of revenue or income to functions that do not accurately reflect value creation by the companies earning the revenue or income. This letter highlights a number of significant failings of these directives, but is not intended to be comprehensive.

**USCIB supports a consensus-based comprehensive income-tax-based solution applied equally to agreed upon issues in segments of the digitalized economy**

There is agreement that the global economy, businesses and the public sector are digitalizing. Therefore, any solution to agreed upon issues (if any) must apply to the economy broadly, not to narrow segments of the economy. Any solution must also be broadly agreed to by countries to minimize double taxation and controversy, therefore the G20-OECD Inclusive framework is the best forum for this discussion. The EU itself recognizes the importance of a multilateral approach.

USCIB believes that any sustainable solution should:

- a. Comply with treaty obligations (both tax and trade);
- b. Reflect long-standing income tax principles
  1. Local income allocation based on local value creation by the company;
  2. Appropriate recognition of the value of technology intangibles in the income allocation factors;
- c. Minimize double taxation;

- d. Include strong dispute resolution mechanisms;
- e. Minimize uncertainty; and
- f. Provide for consistent, simplified administrative mechanisms.

**BEPS changes and U.S. tax reform may address some issues and should be properly taken into account**

BEPS has changed the international corporate tax landscape. BEPS-driven changes to the PE definition in Article 5 of the MTC and the Transfer Pricing Guidelines have resulted in decentralizing distribution (which is often contrary to efficient and cost-effective business practices). Therefore, companies are booking more revenue in the local/market jurisdiction. Intellectual Property is being on-shored and is subject to tax where the related DEMPE functions take place. The MLI has entered into force with some countries adopting new permanent establishment rules. The tax impact of these changes should be properly evaluated before additional fundamental tax changes are considered for adoption.

U.S. tax reform is a further check on the “nowhere income – no tax” issues that lead to the creation of the BEPS project. The repatriation tax will result in substantial tax on previously untaxed earnings. Going forward the GILTI rules will effectively impose a worldwide minimum tax preventing the accumulation of new untaxed earnings.

Any consideration of changes to the current, post-BEPS, international corporate tax system must start with the identification, on a consensus basis, of needed improvements. Are additional changes required to accomplish the goals of the BEPS project (e.g., align income and taxing rights with location of corporate value creation? Should the international corporate income tax system achieve a different division of taxing rights to reflect changes in the economy? If the latter, this is a more difficult exercise because, if double taxation is to be avoided, when taxing rights are shifted to a country, another country must cede its taxing rights. Countries are always reluctant to give up their taxing rights – particularly the right to tax multinational enterprises. Therefore, consideration should be given to the efforts to align local tax laws with the BEPS project.

**Tax debate needs to consider the economic development impacts of digitalization that create opportunities across the full spectrum of economies and businesses**

The international tax guidance developed throughout the late 90’s and the early 2000’s (as result of the OECD’s e-commerce TAG project) tried to minimize barriers that could have stifled the development of the digitalized economy. Avoiding this outcome has been a significant benefit to global development. Some of the benefits realized at least in part because of the minimization of tax barriers include:

- a. Cloud infrastructure, networks, technology and services create opportunities for all to compete in the world economy and provide an ability to compete for small and medium sized businesses as well as small countries; enterprise cloud computing is a natural progression for traditional businesses as well as governments; and
- b. Companies of all sizes rushing to digitalize their businesses to leverage efficiencies in competing in foreign markets without the costs created by physical presence.

Governments are also digitizing. Governmental digitalization brings benefits in the social, educational, and financial spheres. Tax authorities use digitalization to improve tax administration, both locally and by international exchange of information programs. While these benefits are not as obviously tied to reasonable tax rules, to the extent that governments are looking to the private sector to help them digitize these functions, inappropriate tax rules could stifle that development.

**Business models continue to evolve and the evolution is accelerating:**

It is impossible to design appropriate tax rules without understanding business models. Thus, devoting the resources necessary to understand business models is an essential part of crafting any new tax rules. Business believes that the EU, the OECD and the UN have not devoted sufficient resources to this task. The “state of the art” on this seems to Chapter 2 of the OECD’s Interim Report, which is primarily a historically focused analysis. Even so, there are serious flaws with this analysis, which if uncorrected, will lead to flawed policies. Past is not prologue for the digitalized economy.

While Chapter 2 does not correctly describe many aspects of current business models and getting that description right remains a challenge, there is the more important challenge of developing tax rules that are flexible enough to deal with emerging technologies and further evolution of business models including growth of traditional business models that use new and emerging digital technologies. These new and emerging technologies include: artificial or augmented intelligence, machine learning, the internet of things, blockchain, and augmented reality.

While certain enterprises publicly report user data (daily active users or “DAU”, monthly active users or “MAU”, and annual revenue per user or “ARPU”) they do not value users for financial statement purposes. ARPU is derived by dividing total revenue by users; revenue planning is not derived by multiplying historical users times historical ARPU. This is because users are not assets; they are difficult to attract, are available to current and new competitors, and can be easily lost. For companies that report user data, public risk factor reporting focuses on the activities required to attract and retain users and generate more revenue per user – these are the activities that create value for the enterprise.

**The proposed Directives are based on flawed assertions about how and where enterprises create value and the role of data**

The proposed Directives are based on the assertion that “user contributions” or platform “participation” create value for the enterprise, and that those user contributions form the tax policy basis for the country of user location to assert jurisdictional nexus to impose a corporate income tax on the remote services provider. This theory is not supported by objective facts of how enterprises create value, or by any cogent tax policy argument.

The expression “value creation” is taken from the transfer pricing context; it is not a nexus concept. The principle underlying BEPS Actions 8 -10 is to “*Assure that transfer pricing outcomes are in line with value creation*”. This is a transfer pricing principle that provides a framework to guide consideration of whether an intercompany transfer pricing relationship properly reflects the functions, assets and risks performed or assumed by the two associated enterprises, in compliance

with the arm's length principle. It has no policy content relevant to the nexus standard for direct taxation.

In fact, the enhancements to the Transfer Pricing Guidelines as introduced and accepted by global consensus in the BEPS Project in no way supports the concept that an enterprise creates value at a remote location. The TPG revisions arising from the BEPS Project were intensely focused on the actual activities performed by employees of the enterprise. In every case, the TPG enhancements that focus on the accurate delineation of the contract between the parties, the DEMPE functions performed by parties that seek to earn a return from intangible property, and the control functions performed by entities which are allocated the financial results of bearing risks, focus on the actual functions performed by the *enterprise's* employees. There is no suggestion anywhere that an enterprise creates value in places and through means other than its own employees, assets and risks.<sup>1</sup>

The arguments supporting the proposed Directives have lost focus on the point that the value creation question, to the extent it is relevant for transfer pricing or other purposes, is on how the *enterprise* creates value. An enterprise can create value only through its deployment of labor, capital and risk taking. This can only be done at locations where it operates or at which it invests capital. The enterprise cannot create value at locations where it does not operate or have assets.

The actual value creation activity by the enterprise with respect to users and data is not hard to spot. Data can have value to an enterprise only if it is aggregated and structured in a way that the analytical tools deployed by the enterprise can determine relationships among the individual data points. That value is created solely through the development and deployment of the enterprise's platform and data base analytics tools. Data is merely an input into the enterprise's value creation process. All businesses – not just digital businesses -- collect and use data. Data is of no use to an enterprise until the enterprise is able to make some sense of the interrelationships within the data set. None of that takes place at the spot a user accesses the platform through his or her phone.

Furthermore, not all data is equally useful. To the extent that data is used to target advertisements, the targeting is far from perfect. Information may be incomplete or out-of-date, such that targeted advertisements may, in fact, be targeted improperly.

In our view, the idea that user interactions and data provide a tax policy justification for corporate tax nexus is a novel theory created in order to support a result, rather than being a reasoned application of tax policy principles to the facts of business operations.

To the extent that a jurisdiction wishes to levy a tax by reference to the point of consumption, the jurisdiction may impose a VAT. One of the great successes of the BEPS Project has been the widespread introduction around the world of extraterritorial VAT collection and remittance obligations on B2C sales by nonresident enterprises.

### **The proposed Directives should be debated in the context of tax base reallocation.**

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<sup>1</sup> It is also clear that governments have not and cannot assign a value to user participation. That is, it is impossible to value a cat video.

The proposed Directives represent a proposal to reallocate a portion of the global tax base generated by certain enterprises to the country of user location. The question of whether the current international tax framework creates the appropriate division of taxation rights between source and residence states has been a quiet (and sometimes not so quiet) undercurrent of the BEPS Project. The ongoing discussions concerning the CCCTB constitute another manifestation of the desire among states to debate this issue. These discussions undoubtedly will continue, in the EU, OECD and other fora.

Importantly, those discussions regarding the appropriate allocation of the global tax base are based on sound international tax policy principles, including:

- the allocation of a tax base towards a source state must be balanced by an agreement by the residence state to cede taxation rights
- double tax relief mechanisms must operate efficiently
- principles of general applicability do not allow for sector specific taxation
- international tax treaties cannot be ignored.

The proposed Directives do not respect these principles. The better solution to the tax challenges of the digitalizing economy is to continue the discussions at the OECD level, which are focused on achieving a global consensus on tax base allocation applicable to all enterprises.

### **Revenue based taxes are regressive, create double taxation and may be passed on to customers**

Lower profit margin/loss businesses are more adversely impacted by taxes levied as a percentage of gross revenue. For example, the DST's three percent tax on gross revenues may exceed the entire profit from some of the taxed activities – even for the larger enterprises. This is the case for some of our members that receive commissions for acting as an intermediary or incur a loss on in-scope revenue activities. In cases in which companies' profits are less than 3%, the companies would have two options: pass along the cost to their users/customers (which may be SMEs or start-ups); or cease doing the business that is incurring the DST.

The DST appears to be a proxy for an income tax, since the EU states the DST is intended to be an interim measure that will disappear once the SDP Directive is adopted; tax treaties are renegotiated; and the tax policy goal is to impose the DST on "undertaxed" digital service providers. If the DST is indeed a proxy for corporate taxation of the profits of the targeted companies, it is a very flawed proxy. A three percent rate would essentially attribute all of the profit to the jurisdiction of the location of the user in cases when operating profit measures as the return on sales equals approximately 12 percent<sup>2</sup>. This is a very high allocation of profit to the country of users and effectively allocates little or no profit to the jurisdictions where production and

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<sup>2</sup> The average corporate income tax rate in the EU is approximately 25%. If a MNE earned a 100 of gross revenue and paid the 3% DST, that would equate to a 25% tax on 12 of income. As noted above this is a very high overall rate of return and effectively attributes 100% of the profit to the jurisdiction of the user, a result that does not bear any relationship to actual value creation by the company.

innovation take place.<sup>3</sup> Production and innovation are key to value creation by digitalized business and ignoring those functions is grossly distortive. Furthermore, the jurisdictions where production and innovation take place are unlikely to cede taxing jurisdiction to the location of the user. Thus, the DST inevitably will result in unrelieved economic double taxation. To avoid this result, it is likely that, even if profits exceed 3%, companies subject to the DST will be inclined to pass along this cost to their customers. Thus, advertisers on digital media (which may be SMEs trying to expand their markets) will likely have the choice between passing on their increased costs (the DST that passed along to them) to their customers, absorbing the cost of the DST, or not advertising on digital media. All of these options are likely to decrease business activity.

The EU rules do not permit multiple VATs, thus the DST is designed not to be a VAT. EU VATs permit enterprises to claim a credit for input VAT. This is not a feature of DST (possibly to avoid being considered a second VAT). It is, therefore, possible that the DST may result in cascading application of the tax to gross revenue, depending on how revenue is characterized. One case where this may be possible is the case of traffic acquisition costs (or “TAC”). Search engines improve the more searches they conduct. Companies, therefore, pay TAC, calculated as a percentage of ad revenue related to the search, to acquire searches from other websites. If the TAC is considered ad revenue then the DST could cascade and USCIB is aware of cases in which TAC exceeds 90% of the total revenue received. Even if TAC is not considered ad revenue, because TAC can be so high, it is very likely that a tax of 3% of gross revenue would exceed net profits in many cases.

### **The DST potentially violates national treatment obligations and potentially discriminates against non-EU businesses**

Under the WTO’s General Agreement on Trade in Services (or “GATS”) disparate treatment of foreign service providers and domestic service providers may violate a signatory’s national treatment obligation.

The DST may discriminate against non-EU businesses because: the two-part threshold excludes all but the largest companies; the included revenue streams focuses on U.S. tech “giants”; and the excluded revenue streams protect larger EU digitalized companies. (The exclusions of streamed content, IoT data transmissions, and tangible products seem designed exclude EU companies that might otherwise be within the scope of the tax.)

Thus, the DST may represent a case of de facto discrimination.

### **The mechanics of the DST underscore the focus on certain digital internet-based companies and demonstrate a lack of understanding of business models and technology**

#### Services covered

The DST is proposed to be applied to taxable revenues from each of the following services:

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<sup>3</sup> The European Commission’s impact assessment reports surveying 12 large digital MNEs and finding a median profit margin of 15%.

1. The placing on a digital interface of advertising targeted at the users of the interface: From the display of advertising on a user's device at a time when the device is being used within a Member State;
2. The making available to users of a multi-sided digital interface which allows users to find other users and interact with them and may facilitate the provision of goods and services between users;
3. The transmission (not the collection) of data collected about users and generated from users' activities on digital interfaces.<sup>4</sup>

#### Definition of "user" and location of services

For the revenue from the digital service to be taxable the "user" with respect to the digital service must be located in a Member State in the taxable period. The draft directive defines a "user" as any individual or business. It seems, however, that probably is not an accurate definition. If an individual has multiple devices and each of them has a separate IP address, the rules appear to treat each of those devices or IP addresses as a separate user. Also, paragraph 6 of Article 5 limits the data that may be collected from users, for purposes of applying the directive, to the data indicating the location of users but not their identity. This seems inconsistent with some of the substantive rules described below.

The location of the user depends on the type of service that is being provided. In the case of advertising it is where the user's device is when the advertising "appears". The location of the user's device shall be determined by the IP address of the device or, if more accurate, any other method of geolocation, raising the important issue of whether the IP address can be used as a safe harbor. The use of "appears" rather than "clicks" may create significant issues for companies because many companies are paid for "clicks" rather than displays. If displays are not a revenue generating event, then companies would not track this and would need to create global systems to track the information solely for purposes of the DST. Creating new systems to track global information that is otherwise irrelevant to implement a tax that is intended to be short-lived is a waste of taxpayer resources. In addition, it seems illogical for a Member State to be permitted to tax revenue based on an event that does not generate revenue and is inconsistent with the stated rationale for the allocation keys which have been "set out taking into account the nature of each of the taxable services and, in particular, ***what triggers the receipt of revenues for the provider of the service.***"<sup>5</sup>

In the case of intermediation, there are two alternative tests for determining whether a user is located in a Member State. The first alternative relates to an intermediation service that facilitates the provision of underlying goods or services between users. In that case, the user must use a device in that Member State to access the intermediation service and the user must conclude a transaction. (The DST taxable revenue does not include the revenue realized by the person

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<sup>4</sup> While digital advertising and intermediation are identified by the OECD Interim Report as services that could be targeted, transmission of data is not explicitly identified.

<sup>5</sup> DST Explanatory Memorandum, page 11. (Emphasis added.)

providing the underlying good or service.) The Explanatory Memorandum (page 11) provides the allocation of taxable revenues to the Member State is “carried out on the basis of the number of users who conclude such a transaction in that tax period while using a device in that Member State.”

If the intermediation does not involve the facilitation of underlying transactions, then for purposes of allocating tax revenues to a Member State a user will be considered located in the Member State, if the user has an account for all or part of the tax year allowing the user access to the digital interface and that account was opened using a device in the Member State. This information would be extremely challenging to confirm and would require companies to look back to earlier tax periods to determine where a device was used to open an account and they would have to do this globally. In addition, the opening of an account seems to be a passive activity inconsistent with the premise used to justify the basis of the DST, that user activities create significant value for the digitalized enterprise.

In the case of transmission of data, the service is located in the Member State if the data was generated from the user having used the device in that Member State to access the digital interface. The generation of the data could be in the current year or in a prior period and therefore would require a company to look back to earlier tax periods to determine where data was generated based on the location of the device when that data was generated. It is not clear how this could be determined, since it is unlikely that information concerning the location of the device at the time the data was generated was kept. The Explanatory Memorandum (page 12) provides that the allocation of taxable revenues from the transmission of data collected about users “takes into account the number of users from whom data transmitted in that tax period has been generated as a result of such users having used a device in that Member State.” Again, “users” creates confusion and severe compliance challenges. If one individual uses multiple devices in a Member State, would that data be aggregated into a single “user” account – because a user is an individual? If one individual uses the same device in multiple states, would those be multiple users even though there is still only one individual? Or because identifying information cannot be kept, would each interaction that generates data, be a separate “user”? Would companies be required to keep this information, even if they do not sell data currently, because they might in the future and the prior year data would be relevant?

#### Formulas for allocating taxable revenues

The formulas for allocating taxable revenues to a Member State can be summarized as follows:

The formula for determining the amount of DST due on digital advertising is:  $\text{global taxable revenues from digital advertising (minus VAT or similar taxes)} \times \frac{\text{total number of appearances of advertising on a device in a Member State}}{\text{total number of global appearances of digital advertising on user devices globally}} \times \text{DST rate of 3\%}$ .

The formula for determining the amount of DST due on digital intermediation facilitating an underlying transaction is:  $\text{global taxable revenues from digital intermediation (minus VAT or similar taxes)} \times \frac{\text{total number of appearances of digital intermediation in a Member State}}{\text{total number of global appearances of digital intermediation globally}} \times \text{DST rate of 3\%}$ .

taxes) x number of users concluding a transaction in a Member State/ total number of global users concluding transactions on devices multiplied by the DST rate of 3%.

The formula for determining the amount of DST due on other digital intermediation services is: global taxable revenues from such services (minus VAT or similar taxes) x number of users with an account on that service that was opened on a device in a Member State/ total number of global accounts multiplied by the DST rate of 3%.

The formula for determining the amount of DST due on the transmission of data collected from digital interfaces is: global taxable revenues from such services (minus VAT or similar taxes) x number of users in a Member State whose data has been transmitted and whose data was generated using the digital interface from a device used in a Member State/global number of users whose data was generated using the digital interface multiplied by the DST rate of 3%.

These formulas are deeply flawed. USCIB believes they allocate based on users because the premise for special rules for the digital services is that somehow the relationship with users creates value in the location of the user. But these allocation formulas create obvious distortions and those distortions undercut this argument. Some of these distortions will be pointed out below in the discussion of each of the allocation formulas.

#### *Allocating revenues from advertising*

If the thresholds are met, then a company would be required to track global revenues. This would require a foreign affiliate of MNE to track, for example, all its advertising displays (even though the foreign affiliate has no or very few EU users and therefore would not exceed the threshold on an individual basis) to determine the global displays in the denominator of the allocation formula. There is no attempt to define a display. Without an effective definition, it would be difficult for companies to monitor displays and allocate revenue generation. If a “user” navigates away from a site and then back to the same site is that one or two displays? Does an ad have to be of minimum size or duration? If the same ad is displayed on the both sides of the screen, is that one or two displays? If the ad will only be seen if the user scrolls up or down (as is common in ads inserted in newspaper articles), is that a display even if the user does not scroll through the ad? What if ads are blocked or muted? These questions (and many others) would need to be resolved before companies could comply and Member States could audit.

Moreover, the allocation formula for ads ignores how ads are priced. Ads are not all priced the same, yet the global allocation formula effectively attributes the same amount of revenue to each display of an ad regardless of how much the purchaser paid for the ad (or whether they paid at all – which they may not have if the payment is only required if there is a click). Ads are supposed to be more effective because advertisers can target the ads to individuals based on data that is available to the search engine, but the allocation ignores this in allocating the revenue across the global base, undercutting the rationale for the DST. Further, as pointed out above, targeting may be ineffective if information is incomplete or out-of-date.

#### *Allocating revenues from multi-sided platforms*

With respect to multi-sided platforms, the user account registration allocation key for multi-sided platforms revenue would attribute the same amount of revenue to each account regardless of whether the account holder is an active user or not. Again, the supposed rationale behind these rules are that active users are different from mere consumers and the special relationship results in value creation. Yet a twitter account holder who rarely (or never) tweets would be treated the same as twitter user with millions of followers. Thus, the allocation rule undercuts the justification for the tax; it bears no relation to whether the user is creating value.

Applying the proposed formula for a multi-sided business model to “users” leads to confusing and irrational results. If a user really is an individual, then the transaction described below would potentially create a tax liability under the DST. A US resident individual while in the US searches for and books an accommodation in the US for a stay somewhere in the US. The same individual travels to Europe and conducts a second search while in Europe but books no accommodation. Under the DST as drafted, revenue would potentially be attributed to the EU in these circumstances because the user uses a device in that Member State in that tax period **and** concludes an underlying transaction on that interface in that tax period. There is no requirement that the use of the device in the member state and the conclusion of the transaction be related; they only need to be in the same tax period. There is no justification for attributing value to the EU in this case, nevertheless the likely better reading of the draft directive would be to attribute revenue to the EU. This also seems inconsistent with paragraph 6 of Article 5. How would the taxpayer know that there was a search and a conclusion of an underlying contract in the same tax period? This would require associating two events that occur at separate times based on the identity of the user – and yet the only information that may be collected is the location of the user and not their identity.

There are further anomalies from allocating based on “users”. If one individual books 20 stays using an accommodation website, does the EU intend to count that “user” once since it is only one individual or 20 times -- each time it books an accommodation. The allocation formula is based on users, not bookings, so it seems like each user is counted only once. If so, the allocation formula would over allocate revenue to relatively inactive users, contrary to the underlying rationale for the DST. Does the answer change if the individual uses different devices with different IP addresses to book these accommodations? If, however, the taxpayer cannot track the identity of the individual does that mean that contrary to the allocation formula each booking would be a separate “user”? For ride sharing services, why is global revenue relevant? Is revenue attributable to each rider based on the number of rides the individual takes or only the number of riders? If the revenue is determined by the number of riders, then revenue may be disproportionately allocated to the Indian market<sup>6</sup>, simply because of the large number of riders and disregarding that the revenue from a ride in Paris may differ significantly from a ride in New Delhi. If the ride is billed to a business would all the rides taken by that “user” – the business – be counted as a single user. It seems that the allocation formula relates to users not rides, so the allocation formula would be very distortive and over allocate to users who take relatively few rides and under allocate to business use, since that would all be aggregated. Again, how does this relate to the inability to track

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<sup>6</sup> India is a very large market for Uber.

identity? If the taxpayer cannot track identity is the allocation based on rides, regardless of the definition of user?<sup>7</sup>

Like in the case of advertising, the pricing of these services is not uniform across transactions, yet the global formula will essentially allocate the same revenue to each global transaction.

#### *Allocating revenues from the transmission of data*

This entire category illustrates the EU's failure to understand business models. Companies generally do not sell raw data, so there may be no revenue generated from the transmission of data and therefore nothing to allocate. Data is used internally to provide other services. If, for example, an individual searches for an item online, the search engine does not sell the raw data concerning the search. Rather the search engine has auctioned the right to display ads in response to that search query. The company may also aggregate and anonymize data in ways that would create value, but the value derived from this "data" would relate to the company's application of data analytics to the raw data.

Assuming that some companies do transmit data, most data has a very short shelf-life. Under the allocation formula, however, data never expires and companies would need to go back to years before the enactment of the directives to determine the location of the user when data was generated. This is likely impossible.

Further, because the only information a taxpayer is permitted to track is the location of the user when the data is collected, each separate collection would need to be tagged with that location and preserved potentially forever in case the taxpayer sells this data. This would need to be tracked and preserved globally, all for an interim tax that is intended to be phased out.

#### **Significant digital presence proposal**

As noted above, USCIB believes that changes to the taxation of cross-border income must be broadly agreed to by countries and should apply broadly to agreed upon issues relating to broader economy and not attempt to single out "digital" businesses. The economy is rapidly becoming the digital economy so an attempt to "single out" digital businesses is more likely to result in changing the entire international corporate tax system and should be considered in that light.

USCIB objects to the significant digital presence ("SDP") proposal because it targets "digital" businesses. The definition of digital services: "services which are delivered over the internet or electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology", ignores the significant human intervention that is required to create, operate and maintain the systems that permit the service to be provided.

The definition of "users", which is the same here as in the DST, is similarly confusing and distortive. One of the thresholds for determining whether the digital presence is significant requires a minimum of 100,000 users, which whether it is reasonable if users are actual individuals or

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<sup>7</sup> Tracking based on rides would not eliminate distortions attributable to different pricing in different markets.

businesses, is clearly unreasonable if users are IP addresses. Individuals may have multiple IP addresses. There are the obvious cases of individuals having multiple computers, tablets, and phones, but also the expansion of technology to other devices may multiply users. Is a connected car a separate user? How many users are created by variable IP addresses frequently used by internet service providers? Depending on how these questions are answered, the 100,000 user threshold may be no threshold at all.

Article 5 of the SDP directive requires the use of the profit-split method (unless the taxpayer proves another method is more appropriate) and gives no guidance on how the profit would be split other than generic guidance providing “splitting factors may include expenses for research, development and marketing as well as the number of users and data collected per Member State.” This essentially punts on providing any guidance on how profit should be allocated which is certain to be a contentious issue since increasing the allocation to countries based on users and data will require other countries to give up taxing rights if double taxation is to be avoided. Elevating profit split to the default method is directly contrary to OECD BEPS Action 8-10 guidance categorizing profit split more as a method of last resort.

The SDP directive also glosses over the fact that adopting these rules would essentially require countries to cede sovereignty with respect to a fundamental aspect of their tax systems: the determination of the base on which corporate income would be imposed. The SDP proposal even though it is sketchily outlined, would require significant movement towards global formulary apportionment, which countries have rejected at least in part because of it requires consensus on aspects of the computation of the corporate income tax and apportionment factors. If consensus cannot be reached, then different tax bases or apportionment factors would create double taxation. The EU has been unable to reach agreement on the CCCTB (or even the less contentious CCTB) because these issues are so contentious even within an economic bloc. These problems exist before taking into account the difficulty of accounting for users and data. Because the SDP directive suggests including users and data in the allocation formula, it would import all the difficulties identified with respect to defining users and tracking data into the profit allocation formula.

Finally, the two directives are intended to be a package. The DST is supposed to be simple solution that could be implemented quickly while the SDP directive could be finalized and implemented both within the EU and extended outside the EU through modifications to the tax treaty network. The DST is not simple and could not be implemented quickly or without great expense and modification to global business systems. The SDP directive is far from agreement because of lack of political agreement to shift taxing jurisdiction. Even if there were political agreement to shift taxing jurisdiction, there is no viable proposal that could implement that agreement – effectively making

the DST the real permanent solution. Furthermore, it is essential that the effects on economic growth, particularly from enterprise IT technologies, be taken into account before pursuing additional levels of tax, that if warranted, should be directed at agreed upon issues relevant to the broader economy.

Sincerely,

A handwritten signature in black ink, appearing to read 'William J. Sample', written in a cursive style.

William J. Sample  
Chair, Taxation Committee  
United States Council for International Business (USCIB)

Cc: Stephen Quest, Director-General, Directorate-General for Taxation and Customs Union,  
European Commission  
Valère Moutarlier, Director, Direct Taxation, Tax Coordination, Economic Analysis and  
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