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A fair & competitive digital economy – digital levy

Prosus comments on the European Commission's public consultation of 18 January 2021¹

Summary

Prosus is a global consumer internet group and one of the largest technology investors in the world. We grow by investing in leading local businesses and by partnering with the local founders of these businesses. Prosus is a strong supporter of a global, profit-based tax solution that would replace the fragmented and distortive gross-based unilateral measures, remove imbalances in, and modernize, the international tax system by creating a level playing field. We welcome the opportunity to provide comments on the EU public consultation on the design of an EU digital levy as launched on 18 January 2021.

Key points:

- The digitalisation of the economy is a transformative process that is affecting all businesses and sectors. Any solution should ensure the international tax system is fit for purpose for the future and treats all activities in a market similarly whether conducted through digital means or not.
- Our entities generally perform their activities, generate their profits and pay their taxes on revenues and profits in the local markets where they operate and where their consumers and/or users are located (a local-to-local business model).
- In our view, in order to create a level playing field by scoping the digital tax measure, it is essential to consider the differences in business models used in the digital economy. In this regard, Prosus welcomes the recognition by the European Commission of the existence of different business models in the EU (first building block of the inception impact assessment).

¹ <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12836-Digital-Levy>.

- Prosus believes that any EU solution should recognise business models where profits and revenues are already taxed in the local market where they arose. If not, the solution may lead to an arbitrary re-allocation of profits between local markets.
- Trying to close the gaps that currently exist by introducing additional taxation on revenue for digital companies, on top of the revenue taxes and corporate income taxes which companies with a local-to-local business model already pay would hamper innovation in the EU. Such a solution would confirm or even exacerbate the existing unlevel playing field if also applied to businesses which are already paying their taxes locally.

Prosus strongly supports the global efforts to reach a consensus-based solution to address the tax challenges of digitalisation. If no such agreement can be reached, Prosus recognises the coordinating role of the EU which should follow similar building blocks as the G20/OECD proposals. Any coordinated approach to EU-wide introduction of non-profit based taxes such as revenue-based digital services taxes would only weaken the internal market and worsen the climate for digital innovation in Europe.

Introduction to Prosus

Prosus is a global consumer internet group and one of the largest technology investors in the world. Prosus is listed on the Euronext in Amsterdam with a secondary listing on the Johannesburg stock exchange. Prosus is majority owned by Naspers, a South African company that is more than 100 years old and transitioned over the years from a print media group into a global consumer internet group. Prosus is headquartered in Amsterdam.

Prosus has meaningful (minority) investments in a number of listed internet companies including Tencent, Mail.ru and Delivery Hero. Prosus' investment strategy, in addition to holding these important and valuable listed minority investments, is focused on backing local entrepreneurs who own and run internet companies that address big societal needs in markets with great growth potential.

Prosus grows by investing in leading local businesses and by partnering with the local founders of these businesses. The businesses in which Prosus invests are typically local internet businesses established by local champions. These businesses employ their staff in the same country where they started and where their users or consumers reside. Revenues are reported locally and taxes on revenues and profits are paid locally.

Prosus is organised into the following six business areas or segments:

- Classifieds, providing mobile and digital local marketplaces to connect buyers and sellers
- Payments & Fintech
- Food delivery
- Etail/B2C
- Edtech, offering online education
- Ventures, investing in a variety of early stage ideas

Countries like Poland, Romania, Hungary and Portugal are important markets for Prosus' investments in Classifieds, Payments & Fintech and/or Etail/B2C within the EU. In these markets Prosus operates through local subsidiaries. These local subsidiaries were often acquired by Prosus from local founders and/or early stage investors. In addition to these priority countries Prosus has, within the EU, smaller operations in Austria, Bulgaria, Czech Republic, France, Germany, Italy, the Netherlands, Slovakia, Spain and Sweden.

In most markets where Prosus operates, our local subsidiaries compete against other local businesses. In Classifieds, for instance, most of the leading companies are, like Prosus, local operators with local subsidiaries. Some of them are owned by foreign shareholders. The operating models of the key players in this industry are mostly (semi-)local and only in some instances centralised business models are used.

In Prosus' Payments & Fintech segment competition is often against payment technology companies that also operate internationally. In the Payments and Fintech industry it is more common than in, for instance, the Classifieds segment for operators to use a central technology platform.

In most markets where Etail/B2C operates, competition comes both from smaller specialty online stores but also, on an international level, from Amazon and Alibaba which are key competitors.

Prosus has developed what we believe to be a unique approach to tax on the back of its hyper local business model. We consider paying taxes as an important economic contribution to the societies in which we operate. In our opinion this is particularly important for digital companies whose business models are often questioned by regulators, policymakers, consumers, and society at large.

We strongly and actively support the international efforts to develop a global solution to remove imbalances in, and to modernize, the international tax system by creating a level playing field. In our view, taxes should be fair, balanced and uniform. Companies should pay taxes locally, where they operate and where their users and consumers are.

If negotiations at global level do not succeed, Prosus supports coordination at EU level. However, Prosus strongly believes that such coordination should be based on similar building blocks as recognised by the G20/OECD proposals. This means that a coordinated solution at EU level should be profit-based, recognize that local-to-local businesses are already paying their taxes locally, and guarantee a withdrawal of revenue-based unilateral measures. Only such solution will strengthen the internal market and level the playing field in order to stimulate innovation.

Prosus' views on the starting points relevant for designing a solution for addressing the tax challenges arising from the digitalization of the economy

Prosus supports the positions taken by some governments that companies should pay taxes locally, where revenues are generated, profits originate and value is created. There is an urgent need to create a level playing field for all types of companies, regardless of size and industry, as well as between different business models. This means that when the question where value is created and

tax should be paid is answered, similar activities should result in similar tax outcomes, as otherwise the tax measures will create economic distortions and hamper innovation. Businesses should be taxed based on what they do, not be ringfenced based on what they are or how they are structured.

To meet those objectives, the design of a future-proof tax system needs to start from a common understanding on, and take account of:

- 1) the broad spectrum of businesses, which cannot be segregated into categories of non-digital versus digital businesses;
- 2) different operating or business models, reflecting different degrees of centralization;
- 3) all value-generating elements in the supply chain including those which are created or accelerated by the digitalization of the economy (such as the role of data and the power of platforms); and
- 4) adequate measurement of profitability and a rejection of gross-base and transactional taxes.

1) Types of businesses: recognizing the broad spectrum

The digitalization of the economy is a transformative process that is affecting all businesses and sectors. Any solution should ensure that the international tax system is fit for purpose for the future and treats all activities in a market similarly whether provided through digital means or not.

Trying to make a distinction between digital businesses and non-digital businesses is in our view per definition subjective and arbitrary. In fact, highly digitalised businesses may have started as traditional businesses. In many markets the competition reflects a mix of businesses using different levels of digitalization. Also, in the medium or long term we believe that most businesses will tend to become more digitalised as technology advances and digital solutions, platforms and processes will be part of business processes and strategies in all types of businesses, sectors, regions and business models.

Prosus, for example, started as a South African print media company. This part of the business transitioned to an online media business. Another example are consumer retail stores that nowadays have mixed retail commerce activities. Before, consumers could purchase consumer goods in a brick-and-mortar retail outlet. In addition to the physical store, the consumer often now has the choice to acquire the same product from an online store of the brick-and-mortar retailer, an online-only store, an online brand store, or an online platform on which multiple (e)retailers offer the product.

Also, the fundamental rules governing the EU internal market such as state aid rules aim at guaranteeing that no undertaking is treated differently by the business tax framework. This means that new tax rules should recognise the broad spectrum of businesses in the Union and should not discriminate by sector if this results in an advantage that will be incompatible with the internal market. Similarly, revenue thresholds, if considered as a design option, should be assessed against the existing EU *de minimis* policy that only allow such advantages if they result in very low amounts of state aid in a three-year period.

Finally, when assessing the impact of the COVID-19 pandemic, a bright distinction between the effects on highly digitalised and less highly digitalised businesses appears absent. Indeed, some highly digitalised businesses flourished as the pandemic pushed activity online resulting in higher online revenue and higher market share. In some cases, these higher market shares also led to high profitability. However, other highly digitalised businesses were hit hard by the pandemic. This is obvious in the travel and event ticketing industry. Moreover, some categories of less digitalised businesses, such as supermarkets and grocery stores, saw their revenues and profits increase significantly as consumers could no longer go out and had to stay home. We do not know for certain what effect the lifting of restrictions will have on these, in terms of market shares and profitability. These nuances need to be taken into account when linking the effects of the pandemic to any post-pandemic policies which are being developed, for example by targeting specific sectors. In other words, when designing sustainable tax measures policy makers should look beyond the current disruptions caused by the pandemic.

2) Different operating models: centralised versus local-to-local businesses

It can be argued that some businesses are able to generate, thanks to digitalisation, significant revenues in a country without having any substantial physical presence in such markets or while having only a limited taxable presence there.

The new ways of doing business raise the question of where value is created, in particular in relation to “scale without mass business models”, where relevant interaction is taking place with users and consumers in the market, while the company itself does not have physical presence in the market. As there is no physical presence, the company does not, under the current rules, pay corporate income tax in these market countries.

In contrast with these centralised business models, many businesses are also organised in a hybrid or (highly) decentralised fashion. Decentralised businesses, such as Prosus, are organised locally and pay taxes locally on the revenues earned and profits generated by interacting with consumers and users in the local market. There are many reasons why digitalised businesses or digital activities undertaken by “traditional” businesses are organised locally.

In fact, we have observed that in many countries digitalised businesses typically operate locally. Analyses by the Dutch Central Bureau for Statistics, for example, confirmed that Dutch platforms are mainly targeting the local market.² From our experience in the European countries in which we operate, the same is true there.

It is crucially important to further analyse the business environment at Member State and EU level to take account of these differences in business models in designing new and future proof rules. If taxes are already paid in the local market, there is no reason to include businesses in the scope of measures intended to re-allocate profits to other markets. If both centralised and decentralised business models are subject to the digital levy, without taking

² Centraal Bureau voor de Statistiek, Meer inzicht op online platformen in Nederland, 14 Sept 2020, <https://www.cbs.nl/nl-nl/achtergrond/2020/38/meer-zicht-op-online-platformen-in-nederland>.

account of the existing difference in taxation between these two models, the consequence will be that the existing unlevel playing field will be maintained or even exacerbated.

3) The role of data and the power of platforms

Nowadays, data play an important role in any business, independent of its size or industry. Yet, the precise role that data play in generating profits varies significantly depending on the specifics of the business. Whereas some businesses rely on the sale of data to generate revenues, most businesses, including ours, only use the data generated internally for product enhancement, improving user experience and marketing purposes without disclosing, sharing or selling the data to third parties. In those situations where data are being sold, the most important question to answer is where the profits linked to this revenue should be taxed. In a local-to-local business model, such proceeds are taxed in the country where the users or consumers are located.

Another strength of digitalisation is that it facilitates the building of platforms which bring together supply and demand for services and goods. By doing this, disruption may occur and value can be generated by digital companies which could not be generated as easily before. Platforms can also make available analytical tools that help third parties to make better use of their own data. As such, use of data analytics not only makes digitalised businesses more attractive for local business partners. It also helps to address societal needs.

For example, a number of our food delivery businesses make tools available to restaurants to help them anticipate demand to better serve their customers while avoiding unnecessary food waste. As explained above and confirmed by the Dutch study mentioned, many of these platforms however only operate inside a single country. Only some, mostly high-profile platforms, are operating on a global scale or serve users or consumers in multiple countries.

It is important to realise that in the case of decentralised business models, the value of using data or the value of the platform is generated – and in some limited cases monetised – where the users/customers are located. Only where data is monetised remotely, or when platforms are highly centralised and facilitate many markets from one location, significant tax challenges may arise under the current rules that warrant targeted tax measures.

4) Profit-based taxation and rejection of gross/transaction-based taxes

Tax measures targeted at addressing the tax challenges arising from the digitalisation of the economy should be based on profits. Using revenues as the basis for taxation doesn't recognise the significant investments that are often made to grow a business and the fact that many digital business activities are not (yet) profitable. This is particularly relevant for digital start-up companies that invest in innovation. In practice, it often takes years to grow and to finetune their businesses. For this reason, most businesses, big and small, require years to recover their research and development costs and become profitable (if they don't already fail before reaching this point). Levying taxes from businesses which are not yet profitable will raise the costs for innovation and digitalization and hamper innovation.

This raises the question why transaction-based taxes are nevertheless considered despite their distortive and unfair effects. It seems like such taxes or levies are considered as a substitute for profit-based taxes to avoid the issue of bilateral tax treaties not granting taxing rights to the market country function.

There are some similarities with excise taxes. These are often used to discourage certain activities. That is why excise taxes are used to discourage fuel, alcohol or tobacco use by increasing consumer prices. Using taxes with similarities to excise taxes for activities which governments actually want to promote, such as for example digital innovation, seriously hampers such innovation in the countries where such taxes are levied.

Moreover, when such taxes apply also to businesses which are already paying their profit taxes locally, they will not contribute to levelling the playing field. They actually raise the costs of undertaking digital activities locally and therefore hamper local innovation. This is contrary to the overarching economic policies of many governments and the EU. Tax on revenue on specified activities should also be rejected as it could lead to cascading taxation.

Conclusions and solutions

Digital services taxes (DSTs) create distortions that discourage innovation and local entrepreneurship. All existing DSTs follow a one-size-fits-all approach that does not distinguish between business models. For DSTs the additional layer of taxation will come on top of corporate income taxes and VAT in the local markets, which disincentivizes and discriminates local technology development. This is at stark contrast to almost all government-driven incentives to promote technology development in their countries.

As illustrated in this submission, it is important to recognise the differences in business models and to address this local-to-local issue to level the playing field. Prosus believes that it is possible to design a solution that on the one hand creates the possibility to tax remote digital participation business models in the markets, and on the other hand takes account of the fact that local-to-local businesses already pay taxes locally for the full value creation at a local level.

Prosus believes that this is feasible by creating a carve-out/exclusion for local-to-local businesses. Such a carve-out would lead to significant simplification and lowering of administrative costs, as this means that the rules will not have to be applied where the profits are already appropriately allocated to the market jurisdictions.

A local-to-local business could be defined as a business that has activities which are performed in a market whilst generating revenues almost wholly from users and consumers from that market (e.g., 90%) and which has a business model that does not allow for shifting of the residual profits (or residual losses) to another country. As a result, the digital tax measure would become more targeted in nature, addressing more specifically the unlevel playing field caused by the current tax system.

Such carve-out would ensure that a global or EU solution would be proportionate and help to continue stimulating innovation. Finally, this solution would help to

steer away from arbitrary revenue thresholds that may be at odds with the rules governing the EU internal market.

Prosus will continue to support the efforts to develop a fair, balanced and uniform approach to international taxation and welcomes the opportunity to be part of future business consultations. To that end, Prosus encourages EU policy makers to hold additional public consultations when the proposal for a digital levy is technically advanced to ensure that the rules are aligned with business reality.

A proper understanding and recognition of different business models will help to develop sustainable tax rules that support the policy aims which have been expressed for the EU digital market.

We trust the above comments are helpful and would be happy to respond to any questions regarding this submission.

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