Digital Taxation in the EU

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Why is digital taxation reform needed now?

- Today's international corporate tax rules are not fit for the realities of the modern global economy
- Existing tax rules only allow countries to collect taxes from companies that have a physical presence in their country
- Companies can profit from providing digital services in a country without being physically present

→ Result: there is a disconnect – *or 'mismatch'* – between <u>where value is created</u> and <u>where taxes are paid</u>

European Level Solution: 2-Step Initiative

March 21 2018: European Commission proposes two draft directives:

1. **Interim solution** – Digital Services Tax designed to cover main digital activities that escape current tax rules in the EU
2. **Permanent solution** – Significant Digital Presence where companies will have to pay tax in Member States where they *have a significant digital presence*, even if they have no physical presence there

Current situation:

- December 2018: Parliament adopted the dual initiative by an overwhelming majority (451 v 69, 64 abstentions)
- Council has not reached an agreement – reservations on specific aspects and/or more fundamental objections

2-Step Initiative (continued)

Rationale:

- Help avoid unilateral measures to tax digital activities in certain MSs, which could lead to a patchwork of national responses that would damage the single market
- Uniform 3% tax rate would avoid “tax shopping”
- Apply only as an interim measure until the comprehensive reform is implemented and mechanisms are developed to avoid double taxation
- Based on self-declaration by taxpayers, with possibility to conduct tax audits
- One-Stop-Shop digital portal considered a simple and effective mechanism

Similar tax schemes exist in Israel, India, and some US states

Step 1: Digital Services Tax

Applies to REVENUES created from certain digital activities, which escape the current tax framework entirely

- **TAXABLE REVENUES**: revenues from activities/services where users play a major role in value creation and are the hardest to capture with the current tax rules, such as revenues from:
  - i) placement of advertising on digital interfaces (main value created by user data)
  - ii) sale of user data collected by social media or search engines (main value created by user data)
  - iii) digital intermediary activities that allow users to interact with other users and which can facilitate the sale of goods and services between them (peer-to-peer sales apps)
  - iv) content on a digital interface such as video, audio, games, or text
- **PLACE OF TAXATION**: collected by Member States where users are located
- **TAXABLE ENTITIES**: companies with annual global revenues of €750 million and EU revenues of €50 million - *so small start-ups and scalable businesses remain unburdened*
  - EP proposes EU revenues of €40 million, *but the Commission is against the proposal!*
  - I.E. if TAX RATE is 3%, an annual estimated revenue of € 5 billion could be generated for Member State

Step 2: Significant Digital Presence

Companies have to pay tax in the Member States where they have a significant digital presence, even if they do not have a physical presence there

- **TAXABLE REVENUES**: Applies to PROFITS
- **PLACE OF TAXATION:** Allocation of profits to Member States where the user is based when the service is used
- **TAXABLE ACTIVITIES**: Platform is deemed to have a taxable digital presence or a "virtual permanent establishment" if it fulfils one of the following thresholds:
  - i) revenues from supplying digital services = € 7 million+ per year in the Member State
  - ii) number of users in a MS = 100,000+ users in a taxable year
  - iii) online business contracts for digital services = over 3000 in a taxable year.
- **BENEFITS OF THE SYSTEM**:
  - New rules for attributing profits to companies, better reflecting the way digital activities lead to value creation, i.e. through use of criteria such as data and users
  - Real link between where digital profits are made and where they are taxed
  - Could be integrated into the scope of the CCCTB (initiative to allocate profits of large multinational groups in a way that better reflects where the value is created)
  - Consistent with shaping the global consensus-based solution the OECD seeks to implement by the end of 2020
  - Commission issued a Recommendation to Member States to adapt Double Taxation treaties with non-EU countries along the lines of the proposed directive - *should also apply when there is no DTT*

International Initiatives: OECD & G20

BEPS (Base Erosion and Profit Shifting) Action Plan

- 130+ countries and jurisdictions collaborate on the implementation of the BEPS package
- $240 billion are lost annually due to tax avoidance by multinational companies
- 85+ countries and jurisdictions have signed the Multilateral Instrument on BEPS

BEPS Action Plan: Steps Taken in 2015

- **2015**:
  - 15 actions => soft law instrument - multilateral convention, designed to amend bilateral treaties;
  - Decided by consensus, no directly enforceable binding provisions;
  - Patchwork of existing rules, *not a paradigm shift;*
  - Mix of:
    - Minimum standards
    - Best practices
    - Common approaches

BEPS Action Plan: Steps Taken in 2019

- **May 2019**: 134 members of the OECD/G20 Inclusive Framework on BEPS adopted a **Programme of Work** laying out a process to reach a new global agreement for taxing multinational enterprises
  - Inclusive Framework: global membership, including 70% non-OECD countries and non-G20 countries from all geographical regions
  - **Programme of Work** has two main pillars:
    - **First Pillar** will explore potential solutions for determining where tax should be paid and what activities it shall be paid on, as well as what portion of profits could or should be taxed in the jurisdictions where clients or users are located ("profit allocation/apportionment")
      - New "**nexus**" rules, separate from the concept of "permanent establishment": a company should be taxable in a jurisdiction even if it is not physically present there; it is enough to have a significant involvement in the economy of a jurisdiction through consumer interaction and engagement
      - New "**profit allocation**" rules needed, i.e. rules that go beyond the limitations on taxing rights determined by reference to a physical presence
      - Revenue threshold: e.g. €750 million
    - **Second Pillar** will explore the design of a system to ensure that multinational enterprises – in the digital economy and beyond – pay a minimum level of tax
- **June 2019:** Programme of Work endorsed during the G20 June ministerial meeting in Fukuoka, Japan

Individual Country Initiatives : Within the EU

- **Austria:** online advertising, 5% proposed 2020
- **Belgium**: selling of user data, 3% proposed
- **Czech Republic**: targeted advertising, use of digital interfaces, selling of user data, 7%, proposed
- **Hungary**: advertising revenue, 7.5%, ***implemented***
- **Italy:** advertising, digital marketplaces, transmission of user data, 3%, proposed 2020
- **Spain**: online advertising, selling of data, 3%, proposed
- **UK**: revenues of search engines, social media platforms, online marketplaces, 2%, proposed
- **Poland:** announced but then suspended
- **France**: coming up

Individual Country Initiatives: France

"GAFA" tax published on 25 July 2019

- Revenues of €750 million globally
- Revenues of €25 million in France
- **Digital Services subject to the tax:**
    - Intermediation services (B2C, B2B, C2C)
    - Targeted advertising (based on data collected about users) & advertisement services (purchase, storage, monitoring, performance measurement) based on users data (i.e. placement directed to users located in France, IP located in France)
    - Sales of data on users (located in France)
- **Digital Services NOT subject to the tax:**
    - Online sales of goods & services
    - Messaging & payment services
    - Advertising identical for *all* internet users
    - Sales of data *not* collected via the internet, or for purposes besides ads
    - Regulated financial services

US Reactions to the French Tax Rule

Investigation announced July 10, 2019: challenges structure of the proposed DST, and claims that statements by officials suggest France is unfairly targeting certain US-based tech companies

- Authority under USTR Section 301 of Trade Act 1974

- **Concerns of the investigation:**
  - Discrimination against US companies
  - Retroactivity (applicable since January 1st, 2019)
  - Unreasonable tax policy (departures from US tax policy because it has extraterritorial reach and taxes revenue
- **Current situation:**
  - 90 day truce between US and France agreed to at G7 Summit on August 26, 2019
  - USTR put Section 301 investigation on hold to provide time for negotiations
  - Extension of the truce or final report on the investigation expected by end of November
  - US companies are already paying the tax, but under the deal, France would refund those companies any difference between the amount it is now collecting and what would be due under the OECD deal
- **US Comments:**
  - Are tariffs the best tool to fight DST?
  - Use of unilateral tariffs against France to retaliate against DST?
  - US wants to expand the scope of OECD negotiations to capture "intangible activities" that create value for a company, not just focus on "digital services"
  - Risk of double taxation => companies can be incentivised to set up local operation in a country with a DST to avoid being taxed twice

Individual Country Initiatives: Outside the EU

- **Turkey**: online advertising, sales of content, paid services on social media, 7.5%, proposed
- **Canada:** levy on digital services is consensual among all political parties, based on the French model, already existent in Saskatchewan and Quebec
- **Mexico:**
  - Senate approved a bill in late October, now in the House
  - US Internet Association sent a letter to USTR warning against the bill because it could undermine foreign investment in Mexico

Thank you!

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