Current trends in the taxation of international digital activities

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The status quo

- The **rapid transformation** of the global economy due to **digitalisation** has put new pressures on corporate tax systems internationally.

- In particular, **misalignments** between the **place where the profits are taxed** vs. **place where value is created** occur more-and-more often, leading to increased **tax avoidance** and loss of public revenues.

- The **OECD** and the **EU** have already planned various initiatives to address the above tax issues.

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The BEPS Project

- In 2012, the G20 asked OECD to create an action plan to address base erosion and profit shifting (BEPS) by identifying domestic and international actions to address the problem under a specific timeline.

- Subsequently, in September 2013, OECD/G20 countries adopted a 15-point Action Plan to address BEPS.

- The Action Plan nr. 1 was **named Addressing the Tax Challenges of the Digital Economy**. A Final Report was published in October 2015.

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The BEPS Project (2)

- The Final Report on the tax challenges of the digital economy also included the following conclusions:

✓ *Because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to r**ing-fence** the digital economy for tax purposes*

✓ *While the digital economy does not generate unique BEPS issues, some of its key features exacerbate BEPS risks* [mobility of intangibles, distance selling, etc.].

✓ *Cross-border trade in goods, services and intangibles creates challenges for **VAT** collection, particularly where such products are acquired by private consumers from suppliers abroad.*

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The EU solutions

- In late 2017, the EU Commission and Council officially identified various possible avenues to make the **taxation** of digital activities **fairer**:

1. **A long-term solution**: «*embedding the taxation of the digital economy in the general* ***international corporate tax framework***»; and/or

2. **Short-term measures**, such as an **equalisation tax** on turnover of digitalised companies, a withholding tax on digital transactions or a levy on revenues generated from the provision of digital services or advertising activities.

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The EU legislative proposals

- On 21 March 2018, the Commission advanced two Directive proposals:

1) The **first proposal** aims to reform corporate tax rules so that profits are registered and taxed where businesses have significant interaction with users through digital channels. This forms the Commission's preferred **long-term solution**;

2) The **second proposal** responds to calls from several EU states for an **interim tax** which covers the main digital activities that currently escape tax altogether in the EU.

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The EU long-term proposal

- This proposal aims at setting out a **comprehensive solution** within the existing EU corporate tax systems to tax digital activities in the EU.

- Firstly, the proposal lays down rules to determine a **taxable nexus** for **digital businesses** operating across border in case of a non-physical commercial presence (a "**significant digital presence**").

- Secondly, the proposal sets out **principles** for **attributing profits** to a digital business. These principles should better capture the value creation of digital business models which highly rely on intangible assets.

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The «significant digital presence»

- Under the current international tax framework, a business established in Country A can be taxed on its profits in Country B only when the business holds a physical presence of some sort in Country B.

- Yet, digital businesses can generate profits and create value in multiple countries without the need of any physical presence in the latter countries.

- The concept of "significant digital presence" is meant at creating a taxable nexus in a jurisdiction where the digital business does not have any physical presence.

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The «significant digital presenc»e (2)

- A business holds a «significant digital presence» in an EU state during a specific tax period **if and when**:

1. Its activities consists, wholly or partly, of **digital services** supplied through a digital interface; **and**

2. At the group level, **at least 1** of the following thresholds is met during a tax year:

✓ threshold of > €7 million in annual revenues in that EU state; or

✓ It has > 100,000 users in that EU state; or

✓ Over 3000 business contracts (**B2B**) for digital services are created in that tax year.

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Meaning of digital services

- Digital services are those services:
  - ✓ delivered over the **internet** or an **electronic network**

  +
  - ✓ the nature of which renders their supply essentially **automated** +
  - ✓ involving **minimal human intervention** +
  - ✓ **impossible** to ensure **without information technology**.

- According to the Directive proposal, they also include:

  a) Supply of digitised products, including software and changes/upgrades of software;

  b) Services providing/supporting a business/personal presence on an electronic network (e.g, a website or a webpage);

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Meaning of digital services (2)

c) Services automatically generated from a computer via the internet or an electronic network, in response to specific data input by the recipient;

d) Online Marketplace intermediation services;

e) Internet Service Packages (ISP) **going beyond mere internet access** and including other elements such as content pages giving access to news, weather or travel reports, playgrounds, website hosting, access to online debates or any other similar elements;

f) The services listed in **Annex II** to the Directive proposal.

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Profits distribution

- The rules will be built on the current principles for profit attribution and be based on a **functional analysis** of the functions performed, assets used and risks assumed by a significant digital presence.

- **Transfer pricing** rules are expressly referred to.

- In determining the attributable profits, due account shall be taken of the **economically significant activities** performed by the significant digital presence relevant to the development, management and exploitation of intangible assets.

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The EU short-term proposal

- In the short term, the EU Commission has proposed a **Digital Service Tax (DST)** for **adoption** by EU states.
- The measure is meant at preventing unilateral, non-coordinated actions by single EU states (e.g., Italy).
- The DST is a levy on **gross revenues** that would go **alongside Corporate Income Tax**.

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Who is taxed

- The DST would apply to businesses that meet **two** cumulative conditions:

1. Carrying out supplies of the **digital services expressly falling** withing within the scope of the tax; and, furthemore

2. Being above **both** of the following thresholds at **the group level**:

   ✓ Annual worldwide total revenue above Eur 750 million; and

   ✓ EU annual revenues from digital revenues in the range of at least Eur 50 million.

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Which services are taxed

- The DST would apply to revenues generated with services «*where users play a **very active role** in the **value creation** for the business*», namely:

1. the placing on a **digital interface** of **advertising** targeted at users of that interface;
2. the making available to users of a **multi-sided digital interface («marketplace»)** which allows users to find other users/to interact with them, and which may also facilitate the provision of underlying supplies of goods/services directly between users;
3. the transmission of **data** collected **about users** and generated from users' activities on digital interfaces.

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Which services are NOT taxed

- The DST would **NOT** apply to services consisting in the making available of digital content/solutions. For example, activities such as electronically supplied media, **streamine, gaming, cloud computing services**, etc.

- The **reasons** for such such exclusion also include:

  - Exempting digital services with minimal user intervention;
  - Simplicity;
  - Avoid political pressure by reducing the number of taxpayers/consumers concerned.

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Place of taxation

- There is a need to assign taxing rights. To that extent, the focus is placed on user value creation:

1. Sale of advertisement space: **where** the advertisement is **displayed**;
2. Sale of data: «*where the user whose data are sold used a device to access a digital interface, whether during that tax period or any previous one»;*
3. Availability of digital platform/marketplaces to users: *where the user uses a device…in that tax period to access the digital interface and concludes an underlying transaction on that interface in that tax period*

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Other aspects

- The DST will be charged **annually**.
- The levy will also apply to **domestic transactions**. Otherwise, the EC believes, the new tax would be in breach of the freedom of providing inter-EU services.
- The DST will be levied on **gross revenues**.
- There will be a **single 3% DST rate**.
- Businesses will be able to **deduct** the Digital Tax paid from the Corporate Income Tax base (not from the CIT itself).

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Other aspects (2)

- Payment of the DST will be made to the EU state where the supply takes place in accordance with the place of supply rules.
- Businesses will be able to report and pay the DST by means of an electronic interface similar to the VAT **MOSS**.
- The DST will be **repealed** only when intra-EU long-term, comprehensive measures have been adopted and Double Taxation treaties with third country have been renegotiated for a fair taxation of digital activities.

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