Fair taxation of the digital economy

European Commission
DG TAXUD
The issue at stake

Inadequate tax rules for the digital economy

- Difficulty to tax/opportunities for tax avoidance
- Lack of a level playing field and distortion of competition
- Less revenue for public budgets/negative impact on social fairness
- Risk of internal market fragmentation

Current tax rules
Taxation based on physical presence
Profit attribution based on analysis of traditional factors

Drive towards the digital economy
Increased user contribution to value creation
Increased use of knowledge, data, intangible assets
More complex and global value chains
Data as new source of revenue
All these issues are only set to grow

Source: Global Top 100 Companies by market capitalisation' PWC, 2017; Financial Times Global 500 database, 2006.
Context

- OECD/G20 BEPS Action 1 report (2015)
- Work under Estonian Presidency
- Letter from 10 Ministers of Finance calling for EU action
- European Council conclusions of 19 October 2017
- ECOFIN Council conclusions of 5 December 2017
- Public consultation (October 2017 – January 2018)
- OECD Interim report / G20 Finance Ministers meeting
- **Digital taxation package (21 March 2018)**
The architecture of the proposals

**International level**

will feed discussions at

**EU Contribution**

Comprehensive solution
(change in corporate taxation rules)

Interim solution
(indirect tax)

Digital Presence Directive

Digital Presence Recommendation

Digital Services Tax Directive

will be integrated into

(amended) CCCTB
Comprehensive solution

Policy objectives

- **Misalignment** between place where value is created and place where profits are taxed.

Where to tax?
- Need to update the **taxable nexus** - absence of physical presence.

What to tax?
- Need to adapt the criteria for **profit allocation** - data and users contribute central input to the digital business models.
Significant Digital Presence

*Digital interface required*

- Taxpayer
- MS

Digital interface
Accessible by users
Through which digital services are provided
Significant digital presence

Where to tax?
"Significant digital presence"

- Revenues from supplying digital services exceeds EUR 7 million
  or
- More than 100,000 users
  or
- Number of business contracts exceeds 3,000

What to tax?
Allocation of profits to a "significant digital presence"

- Functional analysis
  Builds on the arm's length principle – risks, assets, functions.
- User activities contribute to economic ownership of intangible assets and to value creation.
- Profit split method e.g. based on R&D expenses or user data collected.
Significant digital presence

- No new tax.
- Within existing corporate tax systems of MSs.
- Applies to entities in a MS or in a 3rd country (where no DTC).
- Solution must ultimately be global.
Interim measure

Why do we need an interim measure?

• Agreeing a comprehensive solution at global level is complex.

• In the meanwhile risk of erosion of tax bases.

• Trend towards diverse unilateral interim solutions → uncoordinated approach and risk of fragmentation of the Single Market ("patchwork" of 28 interim solutions).

• Harmonised interim solution - Digital Services Tax (DST):
  ▪ Protect integrity of the Single Market.
  ▪ Ensure level playing field within the Union.
  ▪ Avoid erosion of national tax bases.
Digital Services Tax

Activities with the highest user participation
Digital Services Tax into perspective

*DST is compliant with:*

**International obligations**
- Double Taxation Agreements
- WTO

**OECD**
- OECD Interim report (chapter 6) does not endorse the introduction of interim measures, but outlines design elements to be taken into account.

**EU law**
- TFEU fundamental freedoms (e.g. freedom to provide services in Article 56 TFEU).
- Other legislation (VAT, data protection...)

**Design of the interim measure**
Digital Services Tax

• Revenues as a proxy for value creation.

• Tax rate - 3% of gross revenues.

• Thresholds (cumulative) – **protect SMEs and start-ups:**
  • € 750 M total annual worldwide revenue; and
  • € 50 M total annual revenue from digital activities in the Union.

• Place of taxation - where users are located - revenues allocated proportionally.

• Reporting obligations - possibility to fulfil through One-Stop-Shop mechanism (VAT-inspired).