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EU Direct Tax Newsalert

European Commission proposes new rules on the taxation of the digital economy

On 21 March 2018, the European Commission (EC) published its EU digital tax package on the taxation of the digital economy which consists of four main parts:

- A Communication to the European Parliament and the Council of the EU
- A proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence
- An accompanying Recommendation to the above proposed Directive relating to the corporate taxation of a significant digital presence, and
- A proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services.

The package thus contains two new draft EU Directives. The EC views the first draft Directive as a comprehensive long-term solution and the latter as the short-term/interim solution to quickly address the issue.

The EC's Communication

In its Communication (non-binding strategy paper), which follows its Communication issued in September 2017, the EC refers to the challenges of adapting the current corporate income tax rules to the 21st century. It recognises, however, the need for a new tax framework that is up-to-date with digital business models and underlines the need for an international solution to the challenges of taxing the digital economy. The EC also states that it is working closely with the OECD to support the development of such an international solution, yet that progress at international level is challenging, due to the complex nature of the problem and the wide variety of issues that need to be addressed. Therefore, the EC has decided to propose comprehensive and targeted solutions at EU level as well.

The draft Directive on the corporate taxation of a significant digital presence

This proposed Directive represents a (long-term) comprehensive solution within the corporate tax systems of the Member States. It lays down rules for establishing a taxable nexus in case of a non-physical commercial presence of a digital business ("significant digital presence"). More specifically, a digital

platform shall constitute a significant digital presence if one or more of the following criteria are met:

- the proportion of total revenues obtained in that tax period and resulting from the supply of those digital services to users located in that Member State in that tax period exceeds EUR 7,000,000;
- the number of users of one or more of those digital services who are located in that Member State in that tax period exceeds 100,000;
- the number of business contracts for the supply of any such digital service that are concluded in that tax period by users located in that Member State exceeds 3,000.

Furthermore, the proposed Directive sets out the principles for attributing profits to that significant digital presence. For attribution of profits, a functional analysis should be completed. The economically significant activities performed by the significant digital presence through a digital platform, include, *inter alia*, the following activities:

- the collection, storage, processing, analysis, deployment and sale of user-level data;
- the collection, storage, processing and display of user-generated content;
- the sale of online advertising space;
- the making available of third-party created content on a digital marketplace;
- the supply of any digital service not listed in points (a) to (d).

In addition, in determining the attributable profits, the profit split method should be the default unless the taxpayer can demonstrate that there is an alternative method (based on internationally accepted principles) which is more appropriate having regard to the results of the functional analysis.

The proposed Directive shall apply to all taxpayers that are subject to corporate tax in one or more Member States and to entities resident for tax purposes in a non-EU jurisdiction, in respect of their significant digital presence in a Member State. It shall not apply if an entity is resident for tax purposes in a non-EU jurisdiction that has a double tax convention (DTC) in force with the Member State in which there is a significant digital presence unless i) that DTC includes similar provisions on a significant digital presence and the attribution of profits thereto to those of the draft Directive, and ii) those provisions are in force.

The EC proposes that the Directive should apply per 1 January 2020. It should be noted that the EC states that it stands ready to work with the Member States to examine how to integrate the provisions in the draft Directive into the proposals for a Common Consolidated Corporate Tax Base (CCCTB).

The EC's Recommendation relating to the corporate taxation of a significant digital presence

For cases where the proposed Directive mentioned above would not apply, the EC's Recommendation outlines how Member States should amend their DTCs with non-EU jurisdictions to reflect a significant digital presence, and attribution of profits thereto as per the above Directive.

The draft Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services

This second proposed Directive represents a targeted (short-term) solution. It introduces a Digital Services Tax (DST) at EU level at a rate of 3% on gross revenue (net of VAT and other similar taxes) derived in the EU by the following activities (save for certain exceptions):

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

Revenues resulting from the provision of a service mentioned above by an entity belonging to a consolidated group for financial accounting purposes to another entity in that same group shall not qualify as taxable revenues. Moreover, if an entity belonging to a consolidated group for financial accounting purposes provides a service mentioned above and the revenues resulting from the provision of that service are obtained by another entity in the group, those revenues shall be deemed to have been obtained by the entity providing the service.

Only entities with both total annual worldwide (i.e. not only within the EU) revenue above EUR 750 million and total annual taxable digital revenues in the EU above EUR 50 million would be subject to the DST, irrespective of whether they are established in a Member State or in a non-EU jurisdiction.

Furthermore, the proposed Directive sets out rules with regard to the place of taxation of the DST which is based on the location of the users of the taxable service.

The proposed Directive also proposes the establishment of a simplification mechanism in the form of a One-Stop-Shop for taxable persons with DST liability in one or more Member States.

The DST becomes due on the next working day after the end of the tax period.

In order to alleviate possible cases of double taxation where the same revenues are subject to corporate income tax and DST, it is expected that Member States will allow businesses to deduct the DST paid as a cost from the corporate income tax base in their territory, irrespective of whether both taxes are paid in the same Member State or in different ones.

The EC proposes that this Directive should also start to apply per 1 January 2020.

Next steps

The EC's proposals will now be sent to the Council and the European Parliament. The Directives need to be formally adopted by the Council by unanimous vote, after consultation of the European Parliament and the Economic and Social Committee. It is envisaged that there will be significant discussion regarding the proposed directives and it remains to be seen whether the required unanimity can be achieved.

