Questions and answers
Making the case for the proposed directives on taxation of the digital economy

I. Main points

1. The rise of the digital economy calls for a new approach to international taxation. The present corporate taxation system, based on the location of physical premises and the presence of employees carrying out the company's operations on site, is inadequate for new digital business models. The result is a loss for the public finances of the Member States on whose territory those companies operate. **For the sake of tax fairness, solutions must be found at international level. But in the meantime, Europe needs to take short-term action to protect the single market.**

2. Until a long-term solution is reached, the digital services tax (DST) offers a solution to the under-taxation of multinational digital companies in certain Member States where value is created:

- As much as possible, unilateral domestic tax measures must be avoided to ensure that they are effective and that Europe's digital single market is not impeded.

- The DST targets companies with a high level of activity (€750m in global turnover, of which at least €50m is earned in the European Union from digital activities that would be covered by the tax). It will not have a negative impact on the growth of small and medium-size businesses or on companies undergoing the digital transition.

- The tax targets purely digital activities, in particular revenue derived from Internet users' participation: online advertising, the intermediation of platforms and the sale of data.

3. The proposal does not conflict with efforts underway to find a comprehensive and definitive solution to the question of digital taxation. The proposed directive to introduce the "digital tax presence" concept is a step in the right direction, in connection with work undertaken at the OECD level, which is expected to release a draft international solution by 2020.

Given the multinational nature of the companies involved, a comprehensive and definitive solution must be shared at international level, especially by the United States and the largest Asian countries.

II. Detailed questions and answers

1. Which companies are concerned?

Large digital companies develop highly profitable Internet-based commercial activities on the territory of States without paying taxes there. Users create a substantial share of the value of the services those companies provide, either actively (through their contributions on websites or the goods they sell or rent) or passively (through personal data collected on those sites). Moreover, these companies benefit from the infrastructure in those countries (regular and high-speed broadband).

To remedy this unsatisfactory situation, those companies should be taxed on the revenues in the States where they are earned.

To that end, the proposed DST targets companies earning revenue from providing certain digital services based on users' participation, namely:

- Online advertising (by taking account of user and traffic data)

- Intermediation by digital platforms that allow users to contact and interact with each other (marketplaces for example)

- Selling user data to third parties

The tax will be levied on companies posting global turnover above €750m, including at least €50m in the Union, earned from digital activities falling within the scope of the tax.

2. Why must action be taken?

International taxation rules do not adequately take the digital economy into account. Current corporate taxation principles, based on physical locations and the presence of employees carrying out the company's operations, is inadequate for new digital business models. The result is a loss for the public finances of those Member States in which those companies operate. Moreover, they have an unfair competitive edge, which creates market distortion.

Finding fast, targeted and effective solutions on the European level to address the problem is therefore a matter of tax fairness until an international consensus on a more comprehensive overhaul of the rules can be reached.

3. Does the DST contradict long-term Internet taxation projects?

Those complementary initiatives are a two-pronged strategy: implementing a sustainable profit-taxing solution in the long term at the same time as a fast, short-term solution to spur multilateral long-term discussions.

The DST is a targeted, interim solution aiming to correct the most glaring instances of unfairness. Adopting it will also strengthen the European Union's credibility.

Consequently, the DST will no longer be necessary when Member States implement a long-term solution. The Austrian Presidency plans to insert a sunset clause in the directive to make that point clear.

4. What is the relationship between the DST and the international work on digital taxation underway at the OECD?

On 16 March 2018, the OECD task force released its interim report on the taxation challenges raised by the digital transition. The report specifies that taxes on the turnover of digital activities must be temporary, targeted and easy to implement, and that cases of double taxation must be kept to a minimum. The DST has been designed to follow those guidelines.

Under current international taxation principles, it is impossible to tax the profits of large digital companies in all the States where value is created. The goal is to have a directly operational solution addressing the harmful consequences stemming from that situation. That will be a way to spur headway in discussions on the other measures.

Negotiations aiming at adapting international corporate taxation principles should be actively supported so that the profits of new Internet-based business models are taxed in the States where they are earned.

In that regard, the present notion of permanent establishment is based on physical presence while the principle of transfer price only takes functions performed by persons into account.

Such a change, which cannot fail to result in a consensus with non-EU Member States, is a long-term goal, as the Commission points out in its recommendation that the Member States adapt their tax conventions. In the meantime, the DST allows Europe to act. Of course, it will be repealed once all the States accept and effectively implement an international solution.

5. How the DST works

a. Why not create a DST on the national level?

Creating a DST on the EU level is necessary for both economic and legal reasons.

Member States' economies are integrated in the EU's single market. Levying a national tax on companies based outside those Member States would be a highly complicated matter. Furthermore, given the nature of the single market, uncoordinated, if not contradictory, initiatives should be avoided.

b. What is the scope of companies covered by the DST?

Companies subject to the DST must cumulatively meet the following conditions:

- Global turnover above €750m. This threshold corresponds to the level decided on within the framework of the draft CCCTB directive as well as the requirement of country by country reporting by multinationals (CBCr);

- Turnover above €50m earned in the EU stemming from digital activities falling within the scope of the tax.

The DST will not affect start-ups or traditional companies developing a digital activity on an ancillary basis. The directive also provides for the exclusion of certain financial services such as loans and through crowd-funding platforms.

6. ***How is turnover linked to a Member State?***

Turnover is linked to the Member State where the users of the digital service are located. As a general rule, a user will be considered as being in the Member State where he or she uses a device, located by its IP address.

The directive calls distinguishing between Member States based on the number of times an advertisement appears in each State (for advertising revenue) or on the number of users (for revenue from marketplace-type intermediation platforms or the sale of data). Digital companies possess such information.

7. Is it possible that the DST will penalise new digital companies, which usually run a deficit, while being painless for Internet giants?

Until a comprehensive solution is found, the DST aims at creating an economic environment that nurtures the growth of innovative new companies in the European Union.

Consequently, only big companies — those posting over €750m in global turnover, of which at least €50m is related to digital activities taxable in the Union — are subject to the tax. That scope meets the objective of the tax, which intends to focus on the biggest companies.

Those conditions exclude *de facto* medium or intermediate-sized new businesses (such as start-ups) as well as traditional companies developing a digital activity on an ancillary basis. The DST therefore does not penalise them, but protects them by restoring the level playing field undermined by possible company tax avoidance schemes. The directive will also call for the exclusion of certain financial services such as loans through crowd-funding platforms.

8. Doesn’t the DST excessively penalise loss-making companies?

The DST is a tax on turnover that does not distinguish between profitable and loss-making companies. However, in actual fact the companies involved are usually highly profitable, as the exponential results posted by the Internet giants attest.

9. The DST will be levied on revenue already taxed by the corporate tax. Will that result in double taxation?

The DST is a tax on turnover. As such, its scope of application focuses on revenue for which the gap between value creation in the Union and effective taxation is the widest. This includes revenue from online advertising; intermediation by digital platforms allowing web-users to interact with each other and that facilitate the sale of goods or the provision of services between them; and selling users’ data to third parties. In general, that revenue is not reported in Member States where the value is created, but in other States, which tax them very lightly, if at all. The present risk is under-taxation, not double taxation.

Moreover, businesses paying a corporate tax will be able to deduct the amount of DST they effectively pay from their taxable base.

In addition, no revenue will be subject to the DST twice. In the hypothetical event of revenue that could be associated with two separate activities falling within the scope of the tax (for example, revenue from online

advertising as well as intermediation), that revenue will be taxed only once. On the other hand, if the same company or companies sell the same data several times (resale), each source of revenue will be taxed.

10. In actual fact, will companies pass the cost of the tax on to their customers?

Digital companies do not bill users for services that generate data and revenue falling within the scope of the DST. Since they are likely to keep their business model, the amount of DST will not be passed on to their customers.

However, it cannot be ruled out that companies subject to the DST might pass the cost on to their customers (advertisers, for example). That being said, those companies also care about keeping their market shares and will have the means to cushion the tax with their margins, which are often very large and higher than those of traditional companies.

The effects of possibly passing the tax on to customers will therefore be limited.

11. Will the tax generate administrative costs that are disproportionate to the marginal gain?

a. For multinationals, only big digital companies are involved. They already have substantial administrative means at their disposal to comply with this time-limited requirement.
b. For Member States, the administrative cost will be relative due to the small number of companies involved (fewer than 200) and the DST's simplified identification, reporting and payment procedure.

12. Why legislate at European level rather than allow Member States to act independently?

Given the lack of action at European level and the urgency of the matter, Member States may decide, while waiting for an overhaul of international taxation, to implement unilateral measures aiming to tax digital companies. Some of them have already moved in that direction.

Domestic initiatives might have major gaps due to the specific nature of the digital economy and the fact that its players usually operate in all Member States (on the scale of the single market) while being physically present in just some of them.

Moreover, national measures might lead to uncoordinated approaches with regard to, for example, the rules of territoriality, scope of application, rates or triggering threshold. Given the risk of overlapping legislation, that lack of uniformity could impede the domestic market's proper functioning. Lastly, it would be a source of complexity for economic players, confronted with a plethora of national rules.

13. Some Member States have voiced opposition to the project. Given the unanimity rule, isn't the DST bound to fail?

The drawback of the unanimity rule must not be overestimated. In recent years, the EU has adopted eight directives on direct taxation involving very sensitive issues, including automatic exchanges and bank secrecy, reporting on rulings and financial arrangements and adoption of common rules against abuse.

It is normal for Member States to express their opinions early in the discussion. They must discuss, listen and negotiate in a context where public expectations are high.

14. The definition of activities falling within the scope of the tax is too vague.

For the sake of practicality, clarity and simplicity, the directive targets categories of revenue. The Commission's draft precisely outlines the scope of revenues subject to the DST. It includes profits from providing certain digital services characterised by the creation of value by users. Consequently, the revenue concerned is earned from:

- Online advertising, which consists of inserting advertisements geared to a user's profile (by taking user and traffic data into account)

- Intermediation by digital platforms that allow users to interact and that can facilitate the sale of goods or the provision of services between users

- Selling users' data to third parties. In practice, that data is collected from users' online activity.

15. Will including the sale of data within the scope of the tax risk causing a taxation chain reaction?

Taxing the resale of data is justifiable because each transaction assumes that value is created, even if the amount is not significant. Including it within the scope of the DST aims to prevent avoidance of the tax in the other two categories. It is therefore important for the sale of data to remain within the scope of the DST.

16. Can the DST be likened to a customs duty?

A customs duty is a tax imposed on imported goods, in other words on the sales activities of companies located abroad.

However, the DST targets all revenue from the provision of certain digital services characterised by the creation of value by users whether or not the company is in the Union. Companies established in Europe will therefore also be affected. The DST, then, cannot be considered a customs duty.

17. Won't the DST trigger a trade and tax war with the United States or prompt other States to shift towards taxation instead of consumption?

International and European discussions on distortions relating to tax avoidance by certain digital companies predate the adoption of discriminatory tax and trade measures by the United States. The two issues are therefore not interrelated, especially since the DST is not discriminatory. It will affect companies based in as well as outside Europe.

The DST, then, does not target companies established in the United States, in particular because it involves certain digital activities based on a coherent criterion, the value stemming from users' participation through the collection and use of their data, independently of the company's location.

Nor is it a consumer tax or a tax based on value created by the market. In the specific case of the Internet, It simply addresses a particular and unique method of creating value without being physically present in a State.