Digital Economy

Taxing the Digital Economy

The EU proposals and other insights

Critical Remarks on the DST Proposal

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IBFD, Your Portal to Cross-Border Tax Expertise

Global **economic interdependence** among subjects (persons and their activities) has enabled their newly obtained **independence from the state**

Antagonism between state/taxpayers -> manifests itself principally in the form of state/multinationals (*rectius* transnational corporations)

Territoriality of rules conflicts directly with the globalism of the relations they try to regulate

A key notion in the ongoing debate is income that

1. is disconnected from national territory ("**nomadic income**") and

2. escapes taxation ("**stateless income**")

Such income is

1. the source of the problems of the current tax system and

2. constitutes the target of actions that have already been undertaken or that are underway *(short and long term solutions)*

“**Stateless Income**” seems to be,

a **by-product of globalization**,

1. borne out of the death of distance
2. spawning a global economy without boundaries.

The **immaterial flow** of dematerialized money emerges in direct contrast with its concrete and material aspect.

There are no longer any material constraints to force money to materialize.

The framework is hence **far beyond**

what tax jurisdictions and legislators

1. used to know and
2. have under their control.

In a nutshell, the notion of “**stateless income**” refers to

- flexible income that can be shrouded in an **invisibility cloak**,
- earned by either
  - **multinational corporations** through paper or virtual transactions functioning as the **connecting factor** between such income and its taxing jurisdiction, or
  - **through digitized (cyber) transactions** not allowing for identification of the provider.

Taxless income is generated as a result of a **patchwork of fragmented national tax regimes**, failing to address the challenges of new technologies and the modern business models driven by digitization.

Transfer pricing within multinational groups sees no boundaries and no territory; **only a single entity acting as a single mind with multiple eyes.**

The same applies to **e-commerce**.

Jurisdictions perceive their taxing power based on **territoriality criteria** built on the existence of links between **taxable transactions** and **national territory**.

The criteria applied by the different jurisdictions are fragmented and inconsistent.

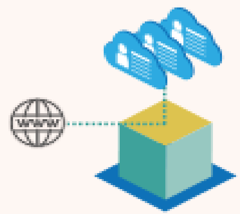
Where states see limits, taxpayers see opportunities; where territories find borders, cyberspace finds loopholes.

While states are accustomed to a **fragmented view**, related companies act as **one for all and all for one**.

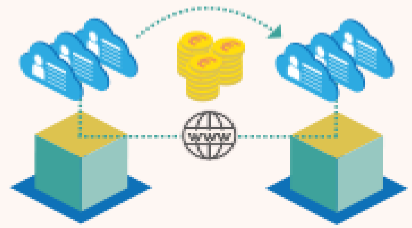
Indeed, the existence of different regimes would be irrelevant if taxpayers did not have the ability to choose between them. Globalization has been a game changer:

states' sovereignty means tax arbitrage is part of the game.

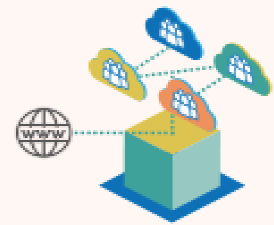
An interim tax of 3% on revenues made from three main types of services, where the main value is created through user participation.



Online placement of advertising



Sale of collected user data



Digital platforms that facilitate interactions between users

... and provided by businesses with:

Total annual worldwide revenue above

750 M€

Total annual revenue from digital activities in the EU above

50 M€

Source: EU Commission

- **Recitals (3):**
  - *The Digital Single Market needs a modern and stable tax framework for the digital economy, to stimulate innovation, tackle market fragmentation and allow all players to tap into new market dynamics under fair and balanced conditions.*

- **Recitals (41):**
  - *The objectives of this Directive aim at protecting the integrity of the Single Market, ensuring its proper functioning and avoiding distortion of competition.*

Is the proposal fit for purpose?

1 First issue: "Temporariness" of the DST

a) Short term.

b) Good reasons to doubt the temporary effect of the tax.

- **The tax is provided to apply until the long-term proposal of the Digital Tax Package is put in place.** The long-term proposal incorporates the concept of the Virtual Permanent Establishment, i.e. the qualification of Permanent Establishment independently from physical presence.
  - Yet, considering the discussions at OECD level, it seems that we are still far from such achievement, with a number of important EU and extra-EU countries opposing to the idea.
- **The proposal itself does not contain provisions for the transition from the short-term solution to the long-term and comprehensive one.**

2 Second issue: "Risk to create distortions" in the Single Market

- It applies only to "**certain digital services**", not all.
  - ✓ Advertising Services: online vs. TV/radio/other
  - ✓ Intermediation services: online vs. otherwise
  - ✓ Thresholds for DST application:
    - ❑ Annual worldwide revenue irrespective of source > € 750 m.
    - ❑ Annual EU revenue from taxable services > € 50 m.
- It applies to **gross income from taxable services,**

  not on profit as per established international tax standards.

3 Third issue: "User location" essential to apply DST

- Identification of user location with certainty is a prerequisite
- Two main risks:
  - ✓ Compliance of user location data collection and processing with the new **data protection** requirements (GDPR)
    - ❑ An additional burden for "certain" service providers?
  - ✓ Ensuring **accurate identification** of location for the purpose of fair taxation and fair allocation of tax revenue
    - ❑ User location on the basis of user's **device(s)** IP address

Is the DST made to be temporary?

Are the taxable services not comparable to services outside the scope of the tax?

Can user-location tracking for DST purposes be effectively enforced in compliance with the GDPR?

There might be room for improvement

To date, in the international arena the outcomes regarding taxation of the digital are:

(1) **unilaterally drafted legislation** that seeks to address the digital challenge within national borders, principally drawing on existing concepts;

(2) **uncomfortable tax law literature** that is just beginning to engage in the debate;

(3) **series** of incomplete and, therefore, not operational **international proposals** regarding potential solutions; and

(4) **questions that are multiplying** together with income that cannot be taxed consistently under the current rules.

Further progress needs to be made and is preconditioned on a **deep understanding of the digital world**.

It is necessary to comprehend 1. how **virtual value** is generated and 2. how it can be translated into **real taxable profit**.

EU vs. OECD?

OECD Brief on the Tax Challenges Arising from Digitalization: Interim Report 2018

There is **no consensus** on the need for, or merits of, interim measures, with a number of countries opposed to such measures on the basis that they will give rise to risks and adverse consequences.

16 March 2018

European Commission - Press release
Digital Taxation

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

21 March 2018

Is DST EU's best alternative?

1. Digital economy is freeing itself from assets and people functions, and it is becoming creative, interactive and unlimited.
2. Digital technology has effected revolution and demands a revolution for taxation to be able to respond to this adequately.
3. International cooperation to regenerate effective taxation would be a good place to start.
4. Basic notions that must be further considered and analysed in this context are
    - the **value of the consumer** and
    - the **market in themselves**, i.e.
        - ✓ the "demand side" of the transaction,
        - ✓ the value of the data, including the mere collection of data,
        - ✓ the value of certain intangibles, such as software, and
        - ✓ its development in the course of its use, and the, even if slight, potential contribution of people functions in the digital value creation chain.

"*Taxing the Digital Economy: The EU proposals and other insights*".

This is the title of our Conference.

This is also the starting point of a new era…

Thank you!