Euro Tax Flash from KPMG's EU Tax Centre

European Commission communication on taxation of the digital economy

European Commission – Digital economy – Digital permanent establishment – Turnover taxes

Following the informal meeting of the Economic and Financial Affairs Council (Ecofin) of the European Union held in Tallinn on September 15 and 16, the European Commission published its Communication on a fair and efficient tax system in the European Union for the digital single market.

The document presents the critical challenges in taxing businesses that provide services digitally and proposes both long-term – a fundamental reform of the international corporate tax framework – and sort-term solutions, such as the introduction of an equalization tax on turnover, a withholding tax on digital transactions or a levy on revenues generated from the provision of digital services or advertising activity.

Background

During the informal meeting in Tallinn, Finance Ministers of EU Member States agreed to reach a common understanding on taxation of enterprises that use digital technology at the Ecofin Council in December. Following a proposal by France, Germany, Italy and Spain for the introduction of an equalization tax, six additional Member States (Austria, Bulgaria, Greece, Portugal, Romania and Slovenia) have pledged their support. Consensus was however not reached, as a number of Member States have concerns about the effects of short-term measures, such as a tax on turnover, and are therefore in favor of a long-term solution that builds on traditional international tax rules.

European Commission Communication

During a press conference organized on September 21, the European Commission presented its communication to the Council and the European Parliament on a fair and efficient tax system in the European Union for the digital single market. The Commission outlines the problems policymakers face in ensuring that the digital economy is taxed fairly and notes that the following two main challenges should be addressed in order to ensure that profits are taxed where value is created:

- Nexus, i.e. determining which state has taxing rights over services provided digitally and a commercial presence is only virtual; and
- Value creation, i.e. allocating profits to such a virtual presence, where value is created through intangible assets, data and knowledge.

The Commission further notes that Member States should address these challenges in a coordinated manner to safeguard fair competition within the EU single market and proposes both long-term and short-term solutions. In the long-term, the Commission recommends that international tax rules should be amended to embed the taxation of the digital economy in the general international corporate tax framework and to update indicators of a significant economic presence in line with the new digitized business model, i.e. an updated definition of the permanent establishment. One challenge that will need to be addressed in this context is the attribution of profits generated by digital businesses by identifying and valuing intangible assets and establishing their contribution to value creation. Alternative approaches to traditional transfer pricing methods will be required, together with specific anti-abuse rules, in order to prevent the shifting of profits outside the country where value is created. At EU level, the Commission mentions the possibility of amending the CCCTB proposal to capture digital activities.

For the short term, the Commission proposes three options:

- An equalization tax on turnover (in line with the above-mentioned proposal that has the support of the Member States). This would take the form of a tax on any untaxed or insufficiently taxed income from digital business activities, either creditable against a company's corporate income tax liability or introduced as a separate tax;
- A withholding tax on digital transactions, which would be levied on a gross value of certain payments to non-resident providers of goods and services online; or
- A levy on revenues generated from the provision of digital services or advertising activity, which would apply on all transactions carried out remotely with local customers by businesses that have a significant commercial presence in that state.

Next steps

While the Commission endeavors to assess each of these short-term solutions in light of double taxation treaties, state aid rules, fundamental freedoms and international agreements, the communication is meant to provide Member States with a basis for further political discussion during the Digital Summit to be held in Tallinn on September 29 of this year. The aim is to achieve consensus on the best way forward during the Council meeting in December, followed by a legislative proposal from the Commission by spring 2018.

Agreement has not yet been reached on solutions at global level within the OECD BEPS Action 1 framework – Addressing the Tax Challenges of the Digital Economy. The OECD will however present its interim report on the taxation of the digital economy to G20 Finance

Ministers in April 2018, with the final report containing policy options and recommendations expected in 2020.

EU Tax Centre comment

There is significant momentum in updating both international and EU rules to allow for the taxation of the digital economy. This topic is of importance to the Estonian Presidency that is likely to push for consensus on a coordinated EU solution. Alternatively, the ten Member States that have expressed their support for an equalization tax may choose to move forward under the enhanced cooperation procedure. It is worth noting that the option of updating the CCCTB proposal to include factors specific to the digital economy is in line with the amendments proposed by the European Parliament rapporteurs for the CCTB and CCCTB dossiers (click here for further details). During the questions and answers session organized by the Commission, Valdis Dombrovskis, Vice-President for the Euro and Social Dialogue, underlined that work will continue on the CCCTB proposal as a preferred solution.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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