

## Informal ECOFIN, September 7-8 2018

### Fair taxation of digital economy

#### PRESIDENCY ISSUES NOTE

##### I. Introduction: Challenges for the EU

Currently, digitalisation creates considerable challenges for international taxation. The Organisation for Economic Co-operation and Development (OECD) already recognised this problem in its OECD/G20 Base Erosion and Profit Shifting (BEPS) project. Hence, an OECD interim report on the issue was presented to the G20 Finance Ministers in March 2018. The final report is due in 2020.

At Union level, the challenge of taxing the digital economy fairly and efficiently has also been identified by the Commission and the Council<sup>1</sup>. The European Council conclusions of 28 June 2018 reiterated the support for this work: *“Ensuring fair and effective taxation remains a key priority. In that context, the fight against tax avoidance, evasion and fraud must be vigorously pursued both at global level (notably in the OECD) and within the EU. At the same time, there is a real need to adapt our taxation systems to the digital era. The Council should therefore take work forward on the Commission proposals on digital taxation.”*

The Commission has put forward two legislative proposals to address these challenges. The first proposal (comprehensive solution) concerns the update of corporate taxation rules in view of the tax challenges posed by the digitalisation of the economy. The second proposal (interim solution) concerns the introduction of a 3% turnover tax – referred to as Digital Services Tax (DST) – on the gross revenues resulting from the supply of certain digital services that will tackle the existing problem in a targeted way until the comprehensive solution is in place.

Ideally, a global and comprehensive solution should be agreed at the OECD and G20 level. It goes without saying that the long-term comprehensive solution to be found in the Council will not only have to be compatible with the EU internal market, but should also take into account the ongoing work in the OECD.

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<sup>1</sup> Ecofin conclusions of 5 December 2017, doc. 15445/17.

At the meeting of the OECD Task Force on Digital Economy (TFDE) in July 2018, countries expressed views on different approaches which will further feed the debate at the OECD level. Some consider that a long-term solution should be focused on the digital economy specifics, notably on user participation as a value driver, while other consider that a broader solution should be applicable. In addition, as some of the key features of digitalisation exacerbate BEPS risks some countries consider that the issue of low taxation should comprehensively be addressed to ensure a minimum level of effective taxation.

However, since the discussions about how to modernise the corporate taxation framework are complex and challenging, it can be assumed that a global solution will take some time.

Pending such a global reform, Member States face the risk of erosion of the corporate taxation bases already now and might be tempted to act unilaterally. Eleven EU Member States have therefore introduced or plan to implement national taxes to cope with the challenges of the digitalised economy, all of them of a diverse nature. These uncoordinated unilateral measures constitute a fragmentation of the Single Market and distort competition. Fragmentation due to national legislation may also hamper the EU's competitiveness as a whole in a globalised world.

This is why a uniform approach for an interim solution - without prejudice to work on long term approaches - is needed.

The two legislative proposals as proposed by the Commission appear to be coherent and compliant with international obligations (WTO and double taxation agreements), as well as Union legislation. Both proposals are based on the concept of user participation in the value creation of digital businesses. The DST seeks to capture this value through an indirect tax on the revenues from the supply of certain digital services, while the comprehensive solution proposes to capture this value through changes to the corporate tax framework and allocation of taxing rights over profits.

Both the interim solution and the long-term solution should be seen as complementary and facilitating early progress to solve the problems set out above in a pragmatic manner.

## **II. Exploring an interim measure (DST)**

The scope of DST according to the Commission's original proposal is - in line with the OECD work - already narrow, targeting only the revenues obtained from services heavily reliant on "user value creation". In this respect, other digital services where user contribution is less clear have been excluded from it (for instance, "e-commerce" or the supply of goods or services contracted online from a retailer, the supply of "digital content", the supply of communication services, or the supply of payment services). Moreover, the scope of DST is not only limited from the perspective of what is taxed, but also from the perspective of who is taxed (through the application of thresholds). In this respect, only entities making supplies of taxable services with revenues exceeding certain thresholds (EUR 750 million of

annual revenues obtained worldwide; as well as EUR 50 million of annual taxable revenues obtained within the Union) would qualify as taxable persons.

Why does the proposed DST focus on services characterised by “user value creation”? The role played by the users of some digital services is unique and more complex than that traditionally adopted by a customer. In fact, user participation constitutes an essential input for certain digital business models to be able to generate revenues (users create value for the company). Moreover, this user input can be obtained remotely, without the provider of the services necessarily being physically established in the jurisdiction where the users are and value is created. Therefore, business models which monetise user input are responsible for creating the greatest difference between where profits are taxed and where value is created. This is why DST targets the revenues resulting from the supply of digital services heavily reliant on user value creation. By the same token DST taxing rights are given to jurisdictions where the users are.

Accordingly the targeted scope of the DST would comprise three particular digital services where user participation contributes most significantly to the value of a business:

- online advertising targeted at users of a digital interface;
- intermediation services through multi-sided digital interfaces which allow 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; and
- the sale of data collected about users and generated from such users' activities on digital interfaces.

However, during discussions in the Council, some Member States have questioned the need to maintain all three taxable services. In particular, some Member States have expressed doubts as to the need to include the sales of data within the scope of DST, besides the taxation of revenues obtained from the supply of online advertising and intermediation services. The main reasons behind the inclusion of each of the taxable services within the scope of DST proposal are, according to the Commission, the following:

#### *Online advertising services*

Placing targeted advertising on a digital interface constitutes the way in which certain companies typically make money with user data. Companies with an advertising-type of digital business model provide a service free of charge (e.g. search engine or social network) and use this to collect user data (knowledge about user preferences and characteristics). They then sell other services (advertising services) which rely on that user information. In particular, the added value of such advertising services is that they are personalised to each user based on his preferences. Such targeted advertising (or “profiling”) would not be possible without user input.

### *Intermediation services*

Multi-sided digital platforms offer a digital space for users to meet and interact. Some platforms also allow users to conclude underlying transactions through those interfaces (in such cases, digital interfaces are also referred to as virtual “marketplaces”). This model monetises user input, in the sense that both demand and supply come from users of the platform that are using it as a virtual marketplace, in cases involving an underlying supply of goods or services. In other cases, platforms generate revenues through selling the right to access the platform and, in other words, selling the right to meet other users (users become “assets”).

### *Sale of user data*

Some digital business models can generate revenues not only through the provision of online advertising, but they may also rely on the outright sale of information about users to third parties.

However, as specified in recital 17 of the Commission’s proposal, DST should not be seen as generally taxing “data”, or the collection of data, or even the use of data collected by a business for their internal purposes or the sharing of data with other businesses for no consideration. What DST targets is the generation of revenues obtained from the sale of data obtained from a very specific activity (users’ activities on digital interfaces). Therefore, data generated from other means (e.g. through the use of sensors) would not be subject to DST if sold to third parties, even if the data is collected through digital means.

### **III. Way forward**

Technical discussions on the two legislative proposals will continue in the preparatory bodies of the Council. The Presidency would like to use the informal ECOFIN to hear Ministers' views on the way forward, in order to facilitate technical work with a view to an early ECOFIN agreement on a DST.

### **IV. Issues for Discussion**

- 1) Do you support the Presidency's intention to focus the technical discussions on refining and stabilising the legal text of the DST, in order to facilitate an agreement by the end of the year?**
- 2) Do you agree that the technical discussions should continue on the basis of all three digital services (online advertising, intermediation services and sale of user data) included in the scope of the Commission’s proposal for the DST or are you in favour of a different scope?**
- 3) In case you are opposed to the inclusion of sale of data within the scope of DST, do you agree that technical solutions should be elaborated to prevent the circumvention of the taxation of online advertising?**
- 4) Concerning the ongoing work in the OECD, do you agree that a common EU position should be prepared on a technical level?**