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Taxing Tech: Will the Digital Services Tax Usher In a New Era for Digital Business?

by Danny O'Connell, Associate Director at Kreab

In March 2018, the Commission released its most ambitious tax reform to date - two legislative proposals on taxation of the digital economy. The long-term solution - the proposal laying down rules relating to the corporate taxation of a significant digital presence - aims to reform corporate tax rules so that profits are registered and taxed where businesses have significant interaction with users through digital channels. The interim solution meanwhile proposes to apply a 3% tax rate on the turnover (not profit) created from activities such as: (i) selling online advertising space, (ii) digital intermediary activities which allow users to interact with other users, (iii) created from the sale of data generated from user-provided information.

In the immediate aftermath of the proposals being released, there was widespread support from most Member States, but negotiations have unearthed concerns on many fronts. Critics have argued that the digital economy cannot be ring-fenced from the economy more generally, and there are strong fears about the step-change in taxing revenue as opposed to profit. Proponents of the tax have argued that the nature of digital business means that this change is absolutely necessary, however.

The European Commission has explained that it is the user-participation that generates the value for the digital businesses and therefore this is the source that needs to be taxed. Other proponents have pointed out that taxing revenue would not be necessary multinational companies were not so efficient at hiding their profits.

Other concerns have been raised such as whether the scope will spill over on to the provision of financial services. This has prompted amendments to the draft legislation to clarify that regulated financial services will not be caught by the tax, but industry representatives are not convinced it goes far enough.

Several Member States, Ireland and Sweden most notably have raised fears on the implications for the EU as a net exporter. Germany and Finland have also called for the removal of the sale of data from the scope of the proposed tax, something which proponents say would open up a huge loophole.

One concern that has been taken on board to some extent is that over low-profit margin companies. The suggestion to have an allowance (rather than a threshold) of €50 million does not fully mitigate this concern but there is a feeling that such considerations are small in the larger context of the file and the broader political debates.

EU Finance Ministers were due to vote to either approve or reject the Austrian Compromise text on the DST at their meeting on 4th December. Instead, they did not engage in any discussion or vote on the text but focussed their attention on a new high-level proposal put forward by France & Germany. This unexpected set of events was put in motion by France as they expected the Compromise text to be voted down. Rather than accept such a defeat, France worked with Germany to come up with a watered-down proposal – only taxing the sale of data – which was put to Finance Ministers.

In their joint declaration, France & Germany urge the Council to agree the new measure by March 2019 at the latest. The levy would enter into force on January 1, 2021, if no international solution has been agreed upon and would then "expire by 2025." Commissioner Moscovici explained that the new proposal would be on the basis of the existing text, and the Commission is prepared to provide assistance to Council to come up with the new drafting. While most Member States welcomed the new approach, several expressed concern. Ireland said it continues to have "strong principled concerns about this policy direction" while Finland expressed "serious concerns" with the new approach. Sweden, Latvia, Hungary and Estonia also issued words of caution.

FURTHER INFORMATION

If you'd like to find out more about the EU taxation policy, please contact Danny O'Connell.

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FTT

Is There To Be Yet Another EU Revival?

Discussions on the proposed Financial Transaction Tax (FTT) have rumbled on since 2012 with no sign of an agreement in sight. On several occasions it has appeared that the tax was dead and buried, only to re-surface thanks to the political enthusiasm of some Member States. In June, France and Germany published their high-level Meseberg declaration in which they pledged to push ahead and show leadership on EU tax reform in several areas, including by re-launching FTT talks to create a tax that would apply in all 27 Member States (post Brexit). In October, the latest chapter in this long-running saga was unveiled with rumours that the Austrian Presidency of the Council was intending to present an updated legal text (based on the French domestic FTT) to the other 9 Member States in the group of 10 participating Member States in the enhanced cooperation process (Austria, Belgium, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia, and Spain). The meeting among the group of 10 on the margins of the Eurogroup on 5th November did not take place however. The group of 10 did meet on 3 December where France and Germany presented their suggested new approach, based on the French domestic FTT, to the other Member States. There was reportedly a lukewarm reception, but no new legal text was presented despite expectations. France and Germany are expected to submit a formal proposal in January, which will then be discussed at a technical level.

CCCTB

Slow Progress under Austrian Presidency

Similar to the FTT, discussions on the proposal for a Common Corporate Tax Base (CCCTB) have been continuing for quite some time but without much tangible progress. While the Austrian Presidency scheduled several meetings on the file, discussions are now effectively stalled. One measure which aimed to inject some impetus into the discussions was the call for national impact assessments to be carried out. Only half of the Member States were able to present these however due to a lack of sufficient data. And those Member States which did produce an impact assessment did so on the basis of no allowances or exemptions in the tax base which undermines the accuracy of the assessments. With no more meetings scheduled at Council level on CCCTB before the end of 2018, the Austrian Presidency will clearly not fulfil their goal of reaching a partial approach on the file. The finger of blame cannot be pointed at Austria however as it is clear that there is still trenchant opposition from many Member States to the concept of a common tax base. Even the intervention of the Independent Commission for the Reform of International Corporate Taxation (ICRICT) – a group of economic and intellectual heavyweights including Joseph Stiglitz and Thomas Piketty who wrote to Jean-Claude Juncker at the start of October to encourage policymakers to adopt the CCCTB to tackle tax avoidance – could not manage to kickstart the discussions. It will now be for the Romanian Presidency to schedule meetings on this file in H1 2019.

EU Tax Blacklist

Deadline Approaching for Annex II Countries to Meet Political Commitments

The EU Tax Blacklist, as agreed by EU Finance Ministers in December 2017, has been successful in effecting change in both blacklisted and grey-listed (so-called Annex II) jurisdictions. Numerous countries have been removed from the blacklist as a result of making political commitments to address the shortcomings in their domestic tax laws. Now the deadline (end-2018) for many of the grey-listed countries to implement those commitments is fast approaching. A recent note from the Council Secretariat on the Council Code of Conduct Group - which will be presented to Finance Ministers for their approval in December – invites the Group to finalise discussions on further coordinated defensive measures against non-cooperative jurisdictions and also endorses the extension of the geographical scope of the EU screening and listing exercise as from 2020. The latter point refers to the decision of the Group at their meeting in September to expand the list of 3rd countries being assessed. Starting from 2020, all jurisdictions that rank high (indicator below 15%) in at least one of two categories (economic ties with the EU and importance of their financial sector), excluding those jurisdictions that rank extremely low (indicator higher than 90%) in terms of institutional stability will come under the scrutiny of the EU Code of Conduct Group. As such, this is confirmation that the blacklist as agreed in 2017 is only the beginning of work in this area. In the more short-term however, EU Finance Ministers will assess in January 2019 whether those grey-listed countries have implemented the reforms they pledged to introduce, and if so, they should be removed from the grey-list.

Future Tax Reform

European Parliament’s Special Tax Committee Releases Ambitious Draft Report

On the 14th November, the European Parliament’s Committee on Financial Crimes, Tax Evasion and Tax Avoidance (TAX3) released its draft own-initiative report. Among many notable aspects, the draft report calls on the Commission to analyse placing cross-border transactional data on a blockchain to combat VAT fraud, points out that citizenship by investment and Residency by investment schemes (i.e. golden visas) carry significant risks, calls on the Commission to analyse reciprocity of exchange of information between the US and Member States, and recalls that the EU’s free trade agreements (FTAs) insist on tax good governance such as via effective use of the EU list of non-cooperating tax jurisdictions. The TAX3 Committee is the 4th iteration of the Special Tax Committee in the European Parliament (following TAXE, TAX2, and the PANA Committees). Despite lacking a legislative role, it has proven itself to be remarkably effective in using its power of publicity to generate action. MEPs will discuss the draft report in the coming weeks with a vote in Committee scheduled for 24th January. Following adoption of the report, the Commission will need to come forward with a legislative proposal at the latest after one year or include the proposal in its next Work Programme. If the Commission does not submit a proposal, it shall give Parliament detailed explanations of the reasons.

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