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Position on European Commission Proposal for a "Council Directive laying down rules relating to the corporate taxation of a significant digital presence" (COM(2018)147final)

Berlin, 11 June 2018

In March 2018, the European Commission published a proposal for a directive on the taxing of companies with a "significant digital presence" in the European digital single market. According to the Commission, the aim of the directive should be a stronger inclusion in tax schemes of companies whose value creation does not take place in Europe.

The Commission intends to introduce the taxation basis for a "significant digital presence" (Art. 4). With this, companies are to be taxed whose revenues or profit[1] or number of users in individual EU Members States exceed a certain threshold, and who do not pay tax in the respective Member States.

Provisos for the taxation of the digital economy

- **Coherent regulation**
  The taxation of companies and business activities should follow regulations which are as unified as possible for all market participants. A separate taxation for "digital business models" must not depart from this principle. Special approaches for certain sectors are not constructive and discriminate against services and products if they are provided digitally.

- **Avoiding double taxation**
  Companies already often run the risk of being subject to double taxation at different locations. This is counteracted in principle by treaties to avoid double taxation. Although not perfect, this contractual system offers some protection against inappropriate double taxation.

- **Fair treatment of the digital economy**
  Tax systems follow classic territorial principles. These must not be abandoned in cross-border business due to governments' fear that they will lose tax revenues. In so far as possible, tax systems should be standardized and harmonized. If territorial principles are maintained, tax systems should follow uniform principles within these provisions.

[1] The German version of the legislative text mentions "Gewinne" (profit), whereas the English version of the text uses the term "revenues". For the translation of the text, we would use thus use revenues or profit.

Regarding the individual provisions

On Article 2: Scope

The blanket application of the draft directive's provisions to all companies, irrespective of the location of their registered office, raises the question of the extent to which the principle of territoriality still holds when it comes to taxation. In particular, since the following articles predicate many of the bases for taxation on this territorial independence – and only certain exemptions are allowed for – the chances that a digital tax in the form outlined will not lead to double taxation must be viewed with skepticism.

On Article 3: Definitions and Annex II & III

Aside from the existing territorial problem, the definitions set out are exposed to a number of functional deficiencies.

For instance, Article 3 (5) classifies the services affected by the provision and attempts to draw a distinction which, in its present form and formulation, cannot be considered to be either commensurate with current circumstances or helpful, and which exhibits numerous inconsistencies. Software, for example, is classified as being uniformly subject to the provision. Games, on the other hand, are only included if they are made available online. If they are distributed on CD-ROMs, they are not covered by the provision. The draft directive makes no statement about distribution on DVDs. This example serves to show that taxation, rather than being based on the asset, is based on the distribution channel, which constitutes unacceptable discrimination against digital services and products.

An additional problem here is that these provisions do not only apply to companies and business and that corporate tax entities from other sectors which may not be primarily commercial – such as charities, the press, and journalism and possibly other services, which receive partly financial contributions via payment services (cf. Art. 3 (6)) – are also affected by the taxation.

On Article 4: Significant digital presence

The grounds for determining a “significant digital presence” are set out in Article 4. The starting hypothesis here is that a permanent establishment in a country exists where there is a “significant digital presence”.

The criteria for determining such a “significant digital presence” are questionable. For example, the criterion that business activities consist wholly or partly of the supply of digital services through a digital interface (Art. 4, Para. 3) extends the scope of application not only to purely digital business models, but also to other services or products that include online components such as, for example, advisory services. Based on additional

assessment thresholds for establishing the existence of a “significant digital presence”, small and medium-sized enterprises with low levels of business activity in a respective Member State should not be subject to the provision. However, the assessment thresholds are set quite low, so that it can be assumed that, in particular, they will be exceeded by digital offers financed by advertising. It is questionable whether the measurement of user numbers and of revenues or profit in accordance with Art. 4, Para. 7 can actually be carried out correctly with respect to Art. 4, Para. 4 and Para. 6.

On Article 5: Profits attributable to or in respect of the significant digital presence

In order to specify more precisely what profits or revenues are generated in a respective Member State in relation to a “significant digital presence”, the Commission describes various transactions that are associated with these revenues or profits. However, these are ultimately so imprecise that it is difficult to assign the relevance of these revenues or profits to an actual “significant digital presence”. Given their extremely general nature, the extent to which the points listed under Art. 5, Para. 5 (in particular Point a) can act as the objective foundations for a taxation basis, is also questionable.

With this type of analysis, the risk of double taxation is also exceptionally high, since the attribution of an individual transaction is very difficult to trace.

The taxation of the sale of “online advertising space” contains potential for unequal treatment of digital advertising compared to advertising in other media, as it explicitly refers to advertising spaces offered online in contrast to advertising spaces on other media. Where possible, the uniformity of tax models should be designed without media discontinuity and, accordingly, such taxation should be avoided.

In summary:

The Commission's proposal for the introduction of a digital tax has many shortcomings and ambiguities which, taken together, could lead to discrimination against services provided digitally and against business models financed by advertising. The further pursuit of this European initiative should therefore be critically reviewed. Especially in view of the fact that the OECD is also working on a solution for the treatment of digital business models in the context of corporate taxation, unilateral European initiatives should be postponed until these concerns have been addressed.

Fair taxation of companies should not be based on the media or on distribution channels. It should be based on general principles and be clearly organized. Double taxation should be avoided here.

About eco

eco – Association of the Internet Industry represents the interests and supports all industries involved in generating economic added value through the Internet. The association currently represents more than 1,000 member organizations.

Amongst others, these include ISPs (Internet Service Providers), carriers, suppliers of hard and software, content and service providers, and communications companies. eco is the largest national association of Internet service providers in Europe.