Kluwer International Tax Blog

Taxing the Digital: Unilateralism Vs. Multilateralism

Piergiorgio Valente (Crowe Valente/Valente Associati GEB Partners; Link Campus University, Rome) · Monday, October 8th, 2018

Taxation of the digital economy remains fixed in the first position of the international tax charts, with the discussions focusing lately on the so-called Amazon tax considered to be introduced in the UK.

The debate has been exalted following respective recent statement by the UK Finance Minister P. Hammond, stressing that the "country needs a new set of taxes to tackle online businesses, which tend to pay far less than their (…) competitors". The background seems to be set by two key factors:

(i) the ever-more evident crisis in the traditional retail business sector, highlighted in particular in the UK with the placement of the House of Fraser under administration;
(ii) the apparently intensifying contrast between:
• the increasing earnings of online retail businesses, and
• their decreasing tax liability,
as seems to be the case with the UK entities of Amazon Group.

The term "Amazon tax" was in fact first used in connection with the – then innovative for the U.S. – introduction of sales tax in New York in 2008. Despite the fact that since 1998 the U.S. Internet Freedom Act limited the power of the States to tax the internet, taxation of e-commerce was possible, provided that some physical connection was evidenced with the taxing State. Following New York, a series of other States adopted Amazon tax.

Ten years later, the issue of the taxation of digital transactions is still considered pending at worldwide level. Indicatively, in the EU forefront, a digital services tax of 5% is expected to be introduced soon in Spain on turnover from specific digital services. Moreover, the Italian Budget Law 2018 had also envisaged a so-called web-tax at a 3% rate on revenue from digital transactions for the provision of services. Although, the tax was initially projected to be effective from 2019, such scenario appears increasingly vague, due to the lack of issuance of required implementing legislation.

During these ten years, considerable efforts have been made in a number of jurisdictions to provide and enforce proper tax laws for digital business activities. Norway, India, Israel, South Africa, Japan are amongst them. Yet, the fierce debate still going on evidences that the problem is of international nature and may only be effectively tackled as such.

On this premise, the question should move to the level of international and supranational tax policy-makers. Indeed, today, they seem to be leading the debate.

From the perspective of the OECD, significant initiatives have been launched in the last five years and they are still ongoing:

(i) Action 1 of the BEPS Project (2013-2015): Addressing the Tax Challenges of the Digital Economy, where the need for further examination of the tax-related question-marks set by digitalization was identified;
(ii) Interim Report on the Tax Challenges Arising from Digitalization (2018) produced through multilateral cooperation in the context of the Inclusive Framework on BEPS and as a follow-up to the aforementioned Action 1;
(iii) Going Digital Project (launched in 2017) aiming at the design of international and interdisciplinary policies for the exploitation of the digitalization opportunity.

The most recent of the above, the 2018 Interim Report, confirms, on the one hand, the widespread consensus on the need for international solutions, while on the other, the lack of such meeting of minds at the current stage. Main conclusion of the report is that identification of common policy may be expected in 2020.

From the EU perspective, the plan is far more concrete. However the division of the Member States regarding the adoption of the proposed measures risks to postpone the adoption of EU-wide solutions even further in the future, if at all.

Specifically, the European Commission has put on the table a Digital Tax Package (Package), including mainly two Directives:

(i) a Directive laying down rules relating to the corporate taxation of a significant digital presence, envisaged for the long-term; and
(ii) a Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, including short-term measures.

The first proposal of a directive provides for the introduction of the concept of digital permanent establishment across the EU, through the revision of the nexus approach and the respective amendment of transfer pricing rules. A digital permanent establishment would be identified on the basis of three cumulative criteria in relation to:

a. annual revenue from the provision of digital services in a Member State;
b. number of users located in a Member State during a relevant tax year;
c. number of contracts for the provision of digital services concluded during a relevant tax year with users located in the Member State.

An amendment of Member States' permanent establishment rules in accordance with the above requires renegotiation of their double tax treaties with extra EU countries, in order to be effective. In this respect, the Digital Tax Package includes recommendations.

The second proposal of a directive assumes that the adoption of the first shall be time-consuming and seeks to ensure for the meantime taxation of specified digital business activities. Common feature of the targeted business models, according to the proposal, is that they rely on value created by the users; such value is considered not to be taxed properly by applying the existing rules. In this light, a digital services tax of 3% is envisaged to apply, under certain revenue-related conditions, on three types of services:

a. online advertising services;
b. intermediation services; and
c. sale of users’ data.

The purpose of the Digital Tax Package as a whole is the update of the tax framework – in the EU and potentially internationally – so that digital business models are effectively taxed, while it is commonly agreed that the existing rules are not adequate. The reason invoked by the Commission for running ahead of the OECD discussions is the need to avoid fragmentation in the Single Market. Indeed, as it was evidenced above, several Member States are in the process of implementing unilateral measures to tax the digital.

Despite the justified purposes underlying the Package, it seems to be raising important concerns – also justified. The most important of them can be summarized as follows:

(i) Member States seem to be rigidly divided with respect to the final adoption of the Package;
(ii) should the Package be adopted, there is significant risk that it awakes reactions from non-EU countries, such as the US;
(iii) specifically with respect to the second proposal of a directive, it can be argued that it prejudices balanced competition in the Single Market by taxing differently service providers offering the same service (e.g. advertising), but applying different means (online advertising as compared to commercial TV or radio advertising).

To sum up, a series of unilateral legislative measures around the world have sought to respond to the question of taxation of the digital. Digitalization however is about transgressing the borders and unifying national realities into a single digital jurisdiction.

In this light, effective solutions can only be multilateral. While multilateral solutions are still clearly far from implementation, concerns with respect to digital giants’ tax liabilities in mismatch with accounting profits shall keep raising.

This entry was posted on Monday, October 8th, 2018 at 10:19 am and is filed under Digitalization, Uncategorized
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