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EU Direct Tax Newsalert

EU Commission issues Communication on the taxation of digital economy

Introduction

On 21 September 2017, the European Commission (EC) issued a Communication (non-binding, strategic policy paper) on the taxation of the digital economy. The Communication will serve as a basis for further discussion among EU leaders at the Tallinn EU Digital Summit of 29 September. The Communication calls for a common EU approach with a view to ensuring "fair and effective taxation across the Digital Single Market". The EC already announced last weekend that it will also possibly present a draft proposal for an EU Directive in spring 2018.

Background

The Communication follows the informal ECOFIN Council meeting of 16 September 2017, in which the Estonian EU presidency, supported by several Member States, called on the EC to explore potential solutions to effectively tax the digital economy. This new agenda is, according to the EC, complementary to other EC initiatives aimed at tackling aggressive tax planning and enhancing tax transparency.

Key elements of the Communication

The EC highlights that the existing international tax framework, based on which the nexus with a particular jurisdiction is determined, using the so called "brick and mortar" requirements, does not sufficiently cover digital companies. Having regard to the underlying principle of taxing profits where value is created, the EC identifies two main policy challenges in this respect. First, the appropriate nexus should be determined where digital service providers perform services and have commercial presence in a tax jurisdiction with no or limited physical presence therein. Second, the attribution of profits based on digitized business models relying on intangible assets, knowledge and data should also be addressed.

The EC further recognizes that an international solution would be ideal referring to the OECD's interim report on the taxation of the digital economy, which is expected to be put forward to the G20 in early 2018. In this respect, the EC suggests a fundamental reform of the existing international tax rules with a view to embedding the digital economy in the general international corporate tax framework.

According to the EC, the new international tax rules will particularly need to address the permanent establishment concept as well as

transfer pricing and profit attribution. The EC is of the view that the Common Consolidated Corporate Tax Base (CCCTB), which uses the formula apportionment method based on assets, labour and sales, adequately reflects where value is created whereby the EC remarks that there is scope in the CCCTB proposal to examine further enhancements to ensure that digital activities are effectively covered.

In addition to this long-term strategy, the EC also puts forward some short-term alternative solutions for more immediate action at the EU and international level such as:

- an equalization tax on turnover of digitalized companies (supported by France);
- a withholding tax on digital transactions;
- a levy on revenues generated from providing digital services or advertising activities.

The EC notes that the options raise difficult questions regarding their compatibility with tax treaties, the EU's fundamental freedoms and State aid rules, free trade agreements and WTO rules, but states that failure to reach agreement on a coordinated approach increases the risk of unilateral action by Member States, which could in its view potentially undermine the Single Market.

Next steps

While the EC's Communication outlines the challenges faced by policymakers and potential solutions to taxing the digital economy in the EU, the EU's medium- to longer-term course of action seems to depend in large part on the OECD's forthcoming spring 2018 report to the G20 on the digital economy. However, there appears to be strong political will amongst at least 10 EU Member States led by Germany and France, supported by the EU Parliament and the EC to pursue an intermediate, EU-only approach in parallel (perhaps including 'quick fixes'), should the developments at the international level prove insufficient. EU leaders will discuss their EU strategic options next week Friday 29 September in Tallinn.

