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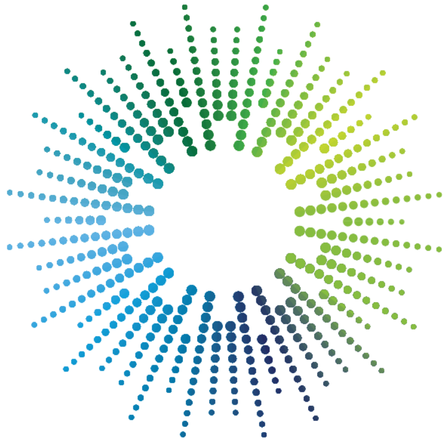

Tax alert
Belgium

European Commission issues draft Directives on the taxation of the digital economy

On 21 March 2018, the European Commission issued two draft Directives on the taxation of the digital economy. Under the proposed new comprehensive solution, companies would have to pay corporate income tax in each Member State where they have a significant digital presence. In the interim, the Commission proposes a 3% revenue-based Digital Services Tax on specific digital services where the main value is created through user participation.

Background

The EU Commission said that EU Member States are under increasing political pressure to act now on taxing the digital economy and an increasing number are considering unilateral action. The proposal for an EU-wide Digital Services Tax would generate revenues estimated to be worth up to EUR 5 billion a year across the EU and help avoid a patchwork of unilateral actions which could fragment the Single Market and create uncertainty for businesses.

Interim proposal – Digital Services Tax

Pending multilateral, international solutions to taxing the digital economy, the Commission is proposing a 3% Digital Services Tax (DST) on the gross revenue resulting from the supply of certain digital services characterised by user value creation:

- **Online placement of advertising**;
- **Sale of collected user data**; and
- **Digital platforms that facilitate interaction between users**, who can then exchange goods and services directly via the platform.

Provision of digital content, payment services, online sales goods or services, and certain regulated financial and crowdfunding services are specifically excluded from the new tax.

The measure is targeted at businesses with:

- Sufficient scale that established strong market positions allow them to benefit relatively more from network effects and exploitation of big data – **total consolidated annual global revenues in excess of EUR 750 million**, and
- A significant digital footprint in the EU – **annual revenues from taxable digital activities in the EU in excess of EUR 50 million**.

The tax will apply irrespective of whether a business is established within the EU.

In line with the concept of user value creation, the tax will be **payable to the Member State where the users are located**. Where users are located in different Member States, one Member State will be responsible for collecting the tax and allocating it to the other Member States, based on allocation keys.

A single EU-wide payment and reporting portal will be established, based on the **One Stop Shop** model currently used for VAT. Businesses will be required to self-assess the tax liability, payable on an annual basis. Consolidated groups will be able to nominate one company to deal with compliance and payment.

It is proposed that Member States will allow resident businesses to deduct Digital Services Tax paid to any Member State from the corporate tax base.

Although the tax is intended as a temporary solution, the proposal does not foresee sunset clauses obliging Member States to abolish them when the common EU solution would be implemented.

Comprehensive solution – significant digital presence

In a separate draft Directive, the Commission proposes common EU rules to allow Member States’ to tax profits generated from a **significant digital presence** in their jurisdiction, regardless of physical presence. The proposal would extend the current permanent establishment rules by establishing a taxable nexus for digital businesses operating across borders where at least one of the following conditions is met with respect to a tax year:

- Revenues from digital services provided to users located in a Member State exceed EUR 7 million;
- Number of active users of digital services located in a Member State exceeds 100,000; or

- Number of business contracts for digital services concluded by users located in a Member State exceeds 3,000.

These thresholds apply by reference to the activities of the services supplied by the entity itself aggregated with those supplied by any *associated enterprises*. The associated enterprises test is widely drawn and includes cases of significant influence through participation in management, a direct or indirect holding that exceeds 20% of voting rights, or participation in the capital through a direct or indirect right of ownership that exceeds 20% of the capital.

A digital service is defined in line with the existing VAT rules ("electronically supplied services" or ESS). Services which can and cannot trigger a significant digital presence are listed, and the sale of goods or services online is specifically excluded.

The proposed transfer pricing principles for allocating profits (or as the case may be, losses) to the significant digital presence follow the established methodology of determining profits that would have been earned by a 'separate independent enterprise' taking into account the, the functions performed, assets used and risks assumed through a 'digital interface'.

A number of additional data and user-related criteria are proposed to recognise the value of user participation and data, including: the collection, storage, processing, analysis, deployment and sale of user-level data; the collection, storage, processing and display of user-generated content; the sale of online advertising space; the making available of third-party created content on a digital marketplace; and the supply of any other digital service. The functions related to the development, enhancement, maintenance, protection and exploitation of intangible assets should be taken into account even if these are not linked to people functions in the same Member State.

The profit split method should be used to attribute profits to the significant digital presence, unless the taxpayer proves that an alternative method based on internationally accepted principles is more appropriate. Possible profit splitting factors could include expenses incurred for research, development and marketing as well as the number of users in a Member State and data collected per Member State.

The Directive would apply between Member States (overriding tax treaties between them) and where a business established in a non-EU country operates through a significant digital presence in a Member State and there is no tax treaty in place. The Commission recommends that Member States update existing treaties with non-EU countries to include corresponding rules on a significant digital presence and profit allocation in line with the proposals.

Timetable and next steps

Each of the two separate draft Directives requires unanimous agreement by Member States for adoption. If agreement is reached, Member States must adopt and publish legislation to comply by 31 December 2019. The measures would then apply from 1 January 2020. The EU also recommends that Member States re-negotiate existing tax treaties with non-EU states in line with the significant digital presence provisions.

The EU would prefer rules agreed at the global level but considers that an unacceptable amount of profits is currently untaxed and has therefore proposed solutions at an EU level. The EU proposals were released within days of the OECD's Tax Challenges Arising from Digitalisation: Interim Report 2018, and the Commission intends that its latest proposals will contribute to the ongoing work at the OECD level to influence international discussions on a global solution.

It is essential that ultimately governments are able to agree a consensus solution over a framework for countries to tax digital businesses based on their profits, in order to minimise double taxation and potential distortions that could affect businesses' commercial decisions.

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