

The European Commission’s ‘Digital Levy’

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SPEED READ

International tax eyes are focused on the new US administration and what impetus that might deliver to the OECD/G20 proposals for addressing tax challenges arising from digitalisation. Simultaneously the European Commission, spurred by the need to raise own resources to finance the Covid-19 recovery effort, seems not to be convinced that international consensus will happen soon enough. A consultation process is underway, looking into possible new forms of EU digital taxation to seek a fairer contribution from companies operating in the digital sphere – but without interfering with the ongoing work at OECD/G20 level.

The European Commission has a new ‘digital levy’ initiative, pending international consensus on digital taxation. Jennifer Maskell and Richard Sultman consider how it might look.

Post-Brexit, the UK is no longer bound to implement new European law. However, there is still much to be gained from looking to what our European neighbours are proposing on the tax front. The increased international focus on taxation of the digital economy is of wide interest, making it useful to have a working understanding of the different proposals that exist from major players on the world stage. Additionally, any measures that Europe proposes (plus the challenges it faces in trying to frame those measures) are instructive for any other jurisdiction, or group of jurisdictions, considering their own move towards taxing digital businesses in a different way.



It is in this light that this article approaches the subject of the European Commission’s recently-launched consultation on the introduction of a digital levy.

How did we get here?

Even before the global pandemic, tax systems across the world were struggling to keep up with the shifting economic landscape. Increasingly the lives of those in developed economies are lived online. Months of travel restrictions and lockdowns, with their emphasis on limiting physical interaction, have only accelerated the move towards digitalisation.

The realisation that ageing tax rules are inadequate to capture the way that the world now works has been a focus of international attention for a number of years. The OECD/G20 Inclusive Framework on BEPS published reports on its [pillar one](#) and [pillar two](#) blueprints in autumn 2020 (covered previously in this journal: see “*OECD publishes pillars one and two blueprints*”, 14 October 2020). Pillar one is, in very broad terms, aimed at addressing the allocation of taxing rights between jurisdictions, for large businesses that face consumers or that are active in the provision of digital services. Pillar two is aimed at ensuring that large international businesses pay a minimum level of tax, regardless of where they operate or are headquartered. Whilst the reports show a level of convergence between the states participating, there is not yet a consensus on how to proceed.

The inadequacy of existing tax systems has been thrown into sharp relief in recent months by the expensive fiscal measures governments have put in place to support businesses and individuals through the Covid-19 crisis. Put bluntly, governments need more money than at any time in the recent past and their tax systems are not currently delivering.

Addressing the taxation of the digital economy would potentially increase tax revenues. However, the scale of the change contemplated by the OECD is sweeping and the progress of reaching consensus has been slow (the OECD itself notes that addressing the tax challenges raised by digitalisation has been “a top priority of the OECD/G20 Inclusive Framework in BEPS since 2015”). The Commission has evidently

now decided that there remains a real risk an international solution will not be forthcoming quickly and intends to put forward its own proposals in the meantime.

What about the EU?

A special meeting of the European Council in July 2020 considered the servicing and repayment of the EU’s borrowing to finance the Covid-19 recovery effort. The [conclusions](#) adopted included proposals for a number of measures to generate additional “own resources”, one of which was a digital levy. In November 2020, the Commission [reaffirmed](#) its commitment to putting a digital levy proposal forward by June 2021, with a view to adopting it by 1 January 2023 at the latest.

It’s worth recalling that this is not the first time the EU has proposed tax measures aimed towards the digital economy. In March 2018, [proposals](#) for two parallel Directives were advanced by the Commission. The first, long-term measure was a reform of corporate tax rules that would deem a digital platform to have a taxable “digital presence”, or virtual permanent establishment, in a Member State where the platform:

- exceeds €7 million in annual revenues in that Member State;
- has more than 100,000 users in the Member State in a taxable year; or
- concludes more than 3,000 contracts for digital services with business users in a Member State, in a taxable year.

As a second, interim measure the Commission proposed a tax on certain revenues from digital activities. Under the proposal the tax would apply at a rate of 3% to revenues created from activities where users play a major role in value creation (for example online advertising, intermediary activities via a digital platform - such as an online marketplace - and selling user data). The tax would be collected by the Member States in which the users are located, and would apply to companies with total annual worldwide revenues of €750 million and EU revenues of €50 million. This interim measure would fall away, once the long term-

reforms envisaged by the other Directive were in place.

The proposals for both Directives were put on hold, pending international consensus on the work arising from the BEPS project. Rather than moving forward with either of the 2018 proposals, the Commission is now seeking views on the design of a new and different digital levy.

What is the EU proposing?

The first step towards formulating a proposal for the new levy was an [Inception Impact Assessment](#) (the “IIA”) released on 14 January 2021. The IIA sets out the purpose and potential implications of the levy. It emphasises the notion that the Commission is seeking “*a fairer contribution from companies that operate in the digital sphere for the purposes of the recovery and to support a more stable medium-term outlook*”. However, it also states that the initiative is “*intended to not interfere with the ongoing work at the G20 and OECD level on a reform of the international corporate tax framework*”.

According to the IIA, the broad policy options under consideration are:

- a corporate income tax top-up to be applied to all companies conducting certain digital activities in the EU;
- a tax on revenues created by certain digital activities conducted in the EU; and
- a tax on digital transactions conducted business-to-business in the EU.

The section of the IIA that deals with the basis for the EU’s intervention suggests that one or both of Article 113 (*harmonisation of indirect tax rules to ensure the functioning of the internal market*) and Article 115 (*harmonisation of other tax rules to ensure the functioning of the internal market*) of the Treaty on the Functioning of the European Union may be relevant, depending on the final design of the levy; this suggests that its precise nature and format is open to debate.

In an initial phase of the consultation the Commission gathered feedback on the IIA itself. The current phase,

which began on 18 January 2021, asks respondents a more targeted series of questions to assist in designing the proposal. No further documents have yet been published to clarify the Commission’s thinking on the likely design of the levy.

Will it achieve its intended aim?

As with most tax reform proposals, the devil will be in the detail – and there is a significant amount of detail to work through. Alongside the broad policy choices, the IIA sets out a number of “building blocks” crucial to designing and targeting the levy correctly. In summary these are:

- the scope and definition of digital activities or transactions, or enterprises, subject to the levy;
- the relationship of the levy with the international obligations that both the EU and its Member States have;
- fairness considerations, including taking into account the possible impact on small and medium sized enterprises, the difference between dominant and weak market positions and the impact on consumers;
- behavioural reactions, including trying to design the levy to mitigate avoidance; and
- future proofing, with an eye on the fact that the digital economy is still evolving.

The feedback to the first phase of consultation is available, appropriately enough, through the EU’s website. Reading even a selection of the responses reveals that opinions are divided; it may be more difficult than the Commission expects to reach a consensus within the EU on what the building blocks should mean in practice. Whilst many points are raised in the feedback, there are some broad themes that emerge.

One is that the digitalisation of the economy does not affect only what might be termed “native” digital businesses, but also increasingly affects other businesses as they add an online dimension to how they provide goods and services. This raises questions about whether all businesses should be in scope to the

extent that they provide digital services (or services through a digital platform), or whether businesses that also operate offline should be treated differently.

As a related point, the consultation responses also raised the possibility that a digital levy could distort competition in the market, if businesses in the same sector begin to be taxed differently depending on how they interact with their customers. Given that the trend is towards more digitalisation, one of the more difficult design tasks is likely to be framing the criteria for a business (or business line) to fall within scope. At what point does a business become “digital” in nature?

Another theme relates to the international dimension. Some responses suggest that unilateral action to tax the digital economy (already taken by some jurisdictions, including the UK, through the introduction of digital services taxes) is incompatible with the EU’s stated commitment to the BEPS project and should be avoided. That said, it is acknowledged that “unilateral” from the EU is preferable to bespoke action from each individual Member State. Whilst some believe that the EU nailing its colours to the mast in this way might represent a threat to the BEPS project ever reaching a consensus, other commentators take the opposite view and believe it may in fact provide additional leverage for international reform. Many of the responses urge the Commission to make clear that any digital levy introduced ahead of measures arising from the BEPS project would fall away, once there is consensus on an international solution.

A third is the concern that the potential levy might have unintended or undesirable consequences, particularly if it is based on gross revenues rather than on a more sophisticated measure. If the levy sits outside the typical mechanics for taxing corporate income, then this raises the possibility that the same amount is simply taxed twice (rather than there being the potential for any digital levy charged to be credited against corporate income taxes charged on the same amount).

For smaller or growing enterprises, or those for whom the transition to a digital platform is in its infancy, the worry is that a digital levy could effectively price them out of the digital market. Similar concerns exist for businesses like wholesalers and retailers, who operate with high turnover but low profit margins. Where digital services taxes have been introduced elsewhere (notably the UK’s own DST), at least some businesses affected have chosen to pass the cost on to consumers. If the levy designed by the EU makes this easy to do, it seems possible that it could raise additional revenue without achieving its fairness objectives, by shifting the economic burden of the levy towards end users.

Action points

Businesses providing digital services in the EU (or that provide services in the EU through a digital platform) should pay close attention to the outcome of the consultation, to see how they might be affected while awaiting OECD/G20 outcomes. Even non-EU businesses will be keen to see what effect any digital levy might have on delivering those outcomes.

- The consultation closes on 12 April 2021, with a detailed proposal from the Commission expected by the end of June 2021.

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