Paweł Uściński

TAXATION OF "DIGITAL ENTERPRISES" CONDUCTING A SIGNIFICANT PART OF THEIR ACTIVITY ONLINE

DOM WYDAWNICZY
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Introduction

The subject of the thesis is to present a wide range of issues regarding the digital tax. "Digital tax" is the concept introduced for taxation of enterprises referred to as digital, i.e. those conducting a significant part of their activities on the Internet. In recent years, the question of how digitalisation should influence tax regulations has become a common point of discussion on modern tax systems.

The natural process is that amidst the development of new technologies, legal solutions change. This is due to the need for adaptation of law to reality at a given place and time. It is no different when it comes to tax law. Its evolution hasn't always been characterised by the pace adjusted to changes in the surrounding world, but it remained indisputable. Novelties implemented to tax law understood both as the introduction of new taxes as well as the evolution in the meaning of particular tax-related concepts, have always been an indispensable part of the economic development. The next stage of this process is the appearance of dedicated regulations in the field of online business, in particular in the area where the internet has introduced business activities previously unknown and not regulated by tax law.

The digital tax understood as the postulated public levy distinguished from the catalogue of other taxes is a relatively new legal invention. At the same time, one may find the sources of the concept aimed at reflecting economically relevant solutions and technologies in the statutory provisions at the end of the XXth century. It was accompanied by legal activities undertaken on various scales, either related to the relevant regulations of international tax rules, with the special role of the OECD (The Organisation for Economic Co-operation and Development) and the EU (European Union) in this respect, or other singular legal solutions.

Currently, the digital tax can be comprehended in a variety of ways. In the most colloquial sense, it is the next one among the catalogue of taxes, public tributes. It reflects the idea of the newly created technical regulation, the significance of which may gradually grow with time.

This idea is implemented through the creation of new, dedicated "digital" taxes which are especially in use at the national levels. At the same time, however, the notion of "digital tax" or "tax on the digital economy" appears as well in a different sense, as the general postulate and new concept for the global tax law. The idea, widely elaborated by the OECD, seeks to reform the current tax solutions in such a way that they become more compatible with the existing economic reality. In particular, it refers to the significant role of the Internet as a medium for doing business, making transactions, buying and selling goods and services, as well as proceeding with other economic activities. Very often, attempts to capture the activities carried out online are made using the existing tax solutions, both direct and indirect ones. This wide concept seems to be equally present in our reality as the idea of the narrowly understood and dedicated technical regulation of the "digital" tax.

The introduction of any among the forms of digital tax described in this thesis may be considered on numerous levels. First, the technical side of the proposed concepts should be considered in the light of compliance with applicable tax regulations and other legal provisions. Secondly, the purposes that the proposal is supposed to achieve and the possible scope thereof should be taken into account. In many cases, it is not only limited to the amount of taxable revenues but also social consequences derived from levying taxes, etc.

Various groups of entities are interested in creating the regulations in question or participating in the process of their creation. These include, first of all, the governments and countries where the debates are taking place and the relevant laws are adopted. Followingly, international organisations, including The European Union and the OECD, whose activity and directions largely determine the future drifts of regulatory activities. Finally, international companies deemed to be charged by the new taxes in a given form.

The purpose of the thesis is to examine the characteristics of global and individual legal solutions in the field of the digital tax, adopted or postulated, as well as to assess the legitimacy of currently undertaken legal actions in this field. To this end, some exemplary solutions are presented, both implemented in specific countries and by international institutions as well as those postulated by scholars.

The first chapter of this thesis concerns OECD actions undertaken in the scope of the issues of the digital activity of enterprises. Focus is given to enterprises deriving important profits from "atypical" forms of business activities. Their activities do not fall within the scope of commonly known and legally regulated actions, characteristically undertaken by non-digital enterprises. Hence, they are considered to escape from the reach of current regulations. The chapter presents the pursuit of international regulations after global consensus in that matter.

Chapter two is the analysis of work carried out at the EU forum. The European initiatives were particularly concentrated around two proposals for directives to regulate the issue of digital tax in the Union. Elements such as the most important foundations of the European concept, its goals, and the consequences are discussed in this chapter.

Chapter three presents regulations regarding digital tax in selected countries. It displays both technical and legal solutions, adopted or debated in these countries, as well as the outlines and crucial elements of public discourse on taxation of the digital economy held therein.

In conclusions, the results of the analysis carried out throughout the thesis are presented, accompanied by recommendations for the future. The thesis takes into account the legal status as of 1 June 2020.

Chapter 1

The concept of digital tax regulations in the work of the OECD

1. INTRODUCTION – THE CORPORATE TAX IN THE INTERNATIONAL CONTEXT

The OECD (The Organisation for Economic Co-operation and Development) plays a very important role in the process of unifying international tax law. The pursuit of solutions in the field of tax regulations on the digital economy is no different. This chapter is devoted to describing the development of work conducted by the OECD throughout the last years, aiming to deal with the phenomenon – taxation of the digital economy.

As will be explained in the following chapters, an argument often referred to in the debates on the digital economy is the necessity to change the current tax principles, remaining out of touch with the realities of the 21st century. The presentation of selected principal provisions, currently being part of the international tax system, and subsequently challenged by the digital reality, is an indispensable starting point for further consideration. By cause of the extensive variety of tax regulations in respective countries, it is also important to identify and to scratch the most common types of provisions present worldwide.

The first subsection is dedicated to the characteristics of the corporate income tax (CIT). Since OECD's work on digital economy taxation largely concerns the re-evaluation and re-assessment of global principles applicable in this regard, it is worth to look deeper at their content. Below the selected CIT-related characteristics and problems are described. Emphasis is put on the global perspective, especially concerning regulations among the OECD countries, having an important significance for subsequent legal deliberations.

The basic problem of the international tax system is determination of the state's right to impose taxes. The inclusion and respect for this right is an important element of international agreements.

The legitimisation of national tax claims is acceptably constituted on two pillars, recognised as the elements of the state's sovereignty, that is power over a territory as well as power over its subjects. Consequently, it creates tax claims arising from personal attachment or territorial attachment[1]. Further distinction arose between the jurisdiction to impose taxes and jurisdiction to enforce them (so-called realistic doctrine)[2].

The general rule is that CIT is imposed on net profits, understood as the difference between receipts and expenses. Two ways of assessments are commonly in use:

– The receipts-and-outgoings system (also known as profit & loss method) generally used in common law countries, the determination of taxable business income is based on the calculation of all recognised income amounts derived by a taxpayer in the tax period and all deductible expenses incurred by the taxpayer in the tax period[3].
– The balance-sheet system (or net-worth comparison method): common in many European civil law jurisdictions. The taxable business income is calculated by comparing the value of the net assets in the balance sheet of the taxpayer at the end of the year plus dividends distributed by the taxpayer during the year with the value of the net assets in the balance sheet of the taxpayer at the end of the previous year[4]. Countries also vary in the aspect of mutual interaction between tax and financial accounting rules, partly consequent, partly remaining independent.

In the context of international tax regulations, the notion of residence is of major importance. National regulations relating to cross-border income taxation cover two types of situations.

The first is the taxation of domestic company's investments going abroad. In this case, countries define residence based on formal (testing the

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1 Schon, W. (2010), Persons and territories: on international allocation of taxing rights, *British Tax Review*, pp. 554–562.

2 Hellerstein, W. (2009), *Jurisdiction to Impose and Enforce Income and Consumption Taxes: Towards a Unified Conception of Nexus in Value Added Tax and Direct Tax: Similarities and Differences*, IBFD, the Netherlands.

3 Thuronyi, V.T. (1998), *Tax Law Design and Drafting,* Vol. 2, Chapter 16, Taxation of Income from Business and Investment, International Monetary Fund.

4 *Ibid.*

place of incorporation) or actual (testing the place of effective management) criteria, possibly on a mixed basis.

The second case is the taxation of a foreign company's investments flowing into the state. The definition of residence is usually based on the mixed model of two concepts: the so-called "worldwide system" and "territorial system". The worldwide system means that residents are taxed based on their global revenues, while the location of the source is irrelevant. Due to problems associated with the need to collect information from foreign jurisdictions, countries rarely decide to apply this system in its pure form. The solution in use is rather a deferral system, that taxes foreign subsidiaries upon repatriation. The territorial system respectively means taxing residents solely based on their revenues obtained from sources located in the territory of the given country[5].

The next key aspect is the notion of the source. Despite the differences arising from regulations in singular countries, tax treaties often introduce the concept of Permanent Establishment (PE) into the domestic legal order. A detailed description of the functioning of mechanisms related to PE is provided below.

Along with the states' sovereign right to impose taxes, the problem of double taxation arose[6]. Tax treaties are the instruments aimed at solving problems in this area. Most bilateral tax treaties are grounded on model conventions, such as the OECD Model Tax Convention[7] and the United Nations Model[8]. This fact is reflected in the construction of bilateral treaties and their substantive elements. Model conventions are also Important instruments that can significantly affect the shape of tax regulations around the world[9].

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5 OECD (2013), *Addressing Base Erosion and Profit Shifting*, Chapter 4, OECD Publishing, Paris.

6 Double taxation is "the imposition of comparable taxes in two (or more) states on the same taxpayer in respect of the same income" – definition from OECD (2017), Introduction, in: *Model Tax Convention on Income and on Capital: Condensed Version 2017*, OECD Publishing, Paris.

7 OECD (2019), *Model Tax Convention on Income and on Capital 2017 (Full Version),* OECD Publishing, Paris.

8 UN (2017), *Model Double Taxation Convention*, New York.

9 Double tax treaties generally follow a relatively uniform structure, which can be viewed as a list of provisions performing separate and distinct functions: (i) articles dealing with the scope and application of the tax treaty, (ii) articles addressing the conflict of taxing jurisdiction, (iii) articles providing for double taxation relief, (iv) articles concerned with the prevention of tax avoidance and fiscal evasion, and (v) articles addressing miscellaneous matters (e.g. administrative assistance) – According to the OECD (2017), Introduction, in: *Model Tax Convention on Income and on Capital: Condensed Version 2017*, OECD Publishing, Paris.

The first research in the field of the application of national rights to tax specific profits took place already in the 1920s. It resulted in the development of the first report in that regard[10]. Gradually, the international network of bilateral treaties expanded according to the methods called "classification" and "assignment of sources"[11]. This happened at the same time as the conventions of the UN and OECD grew in influence. Nowadays, determining the place of taxation happens as follows. First, the income is included in one of the categories defined by the treaties, while they also indicate provisions in case income falls into more than one category. Then, the income is assigned to a particular country, either as the exclusive right for exercising taxation or as a priority in that exercising[12].

As a rule, the country of residence has the right to tax the entire income of the enterprise, unless it also operates in another country (source country) through a permanent establishment (PE). It is a structure that allows defining the proper rules in circumstances when one state has the option of imposing taxes on foreign enterprises. The PE is a reflection of the economic activity carried out by a given entity in a given country. The scientific literature claims that as long as a business does not have a PE in a given country, its economic activity is so small that it does not provide the state with the right to levy taxes[13].

Currently, one can talk about PE in case of a physical presence in a specific place from where the enterprise conducts its business, or possibly the presence of a person acting on behalf of the enterprise. In both cases, physical presence, direct or through an intermediary, is inseparable. Over time, the development of the service market has also led to the possibility of establishing a PE in a place where the services of an enterprise are provided for a sufficiently long time by its employees or other institutionalised persons. Whatmore, the separate regulation allowing taxation in a source country without PE covers incomes from i.e. real estate and certain business

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[10] Bruins G.W.J. et al. (1923), *Report on Double Taxation submitted to the Financial Committee*, No. E.F.S. 73.F.19, League of Nations, Geneva.

[11] "Different types of income are subject to different distributive rules" – from OECD (2014), Fundamental principles of taxation, in: *Addressing the Tax Challenges of the Digital Economy*, OECD Publishing, Paris.

[12] OECD (2019), *Model Tax Convention on Income and on Capital*, OECD Publishing, Paris.

[13] Holmes, K. (2007), *International Tax Policy and Double Tax Treaties*, IBFD Publications, the Netherlands; Rohatgi, R. (2005), *Basic International Taxation*, Vol. I: Principles, Second Edition, Richmond Law and Tax Ltd, United Kingdom.

profits. Also, special rules apply to some types of income, such as capital gains, interests, royalties or dividends[14].

When, according to the treaty, the source jurisdiction is proper to levy the tax, the state of residence must release the taxpayer from the obligation. The release is carried out under one of two mechanisms: the exemption method or the credit method, while usually a mixed model is applied[15].

2. HISTORICAL REGULATIONS ON TAXATION OF THE DIGITAL ECONOMY FOLLOWED BY THE BASE EROSION AND PROFIT SHIFTING PROGRAMME

Adapting tax solutions to current economic challenges entails a long and complex process. Hereunder are enlisted the most important OECD reports and documents issued during this process:

- 1998 – Ottawa report on Electronic Commerce: Taxation Framework Conditions[16],
- 2001 – Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions[17],
- 2012 – The Digital Economy[18],
- 12 February 2013 – Addressing Base Erosion and Profit Shifting [19],
- September 2013 – Action Plan on Base Erosion and Profit Shifting[20],
- 2014 – Addressing the Tax Challenges of the Digital Economy[21],

[14] OECD (2014), *Addressing the Tax Challenges of the Digital Economy*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, pp. 40–42.
[15] OECD (2019), *Model Tax Convention on Income and on Capital*, OECD Publishing, Paris.
[16] OECD (1998), *Report by the Committee on Fiscal Affairs*, as presented to Ministers at the OECD Ministerial Conference, OECD Publishing, Paris.
[17] OECD (2001), *Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions*, OECD Publishing, Paris.
[18] OECD (2012), *Hearings. The Digital* Economy, OECD Publishing, Paris.
[19] OECD (2013), *Addressing Base Erosion and Profit Shifting,* OECD Publishing, Paris,
[20] OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing, Paris.
[21] OECD (2014), *Addressing the Tax Challenges of the Digital Economy*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

– 5 October 2015 – Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report[22],
– 7 June 2017 – Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS[23],
– 2018 – Tax Challenges Arising from Digitalisation – Interim Report 2018[24].

The latest documents from 2019

– Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note[25],
– 13 February 2019 – Base Erosion and Profit Shifting Project – Public Consultation Document Addressing the Tax Challenges of the Digitalisation of the Economy[26],
– March 2019 – Public Consultation in Paris on PoW,
– 28–29 May 2019 – Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy Inclusive Framework on BEPS (PoW)[27],
– June 2019 – G20 Finance Ministers and Leaders at their respective meetings in Japan approve,
– 1 October 2019 – Task Force on the Digital Economy (TFDE) meeting,
– 9 October 2019 Public consultation document Secretariat Proposal for a "Unified Approach" under Pillar One[28],

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22 OECD (2015), *Addressing the Tax Challenges of the Digital Economy,* Action 1 – 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris,

23 OECD (2016), *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, Paris.

24 OECD (2018), *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

25 OECD (2019), *Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note*, OECD Publishing, Paris.

26 OECD (2019), *Addressing the Tax Challenges of the Digitalisation of the Economy*, Public Consultation Document, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf [accessed 1.12.2019].

27 OECD (2019), *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy*, OECD/G20 Inclusive Framework on BEPS, OECD, Paris, www.oecd.org/tax/beps/programme-of-work-to-develop-aconsensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.htm [accessed 1.12.2019].

28 OECD (2019), *Public consultation document Secretariat Proposal for a "Unified Approach" under Pillar One*, OECD Publishing, Paris.

- 8 November 2019 – Global Anti-Base Erosion Proposal ("GloBE") – Pillar Two[29],
- 21 and 22 November 2019 – The public consultation meeting on the proposed "Unified Approach" to deal with Pillar One issues,
- 29–30 January 2020 – Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy[30].

In the ensuing part of this chapter, the proper references were made to indicate how they contributed to the progress of works.

In 1998, a Ministerial Conference on Electronic Commerce in Ottawa took place, in the aftermath of which a report was published: "Electronic Commerce: Taxation Framework Conditions"[31]. At that point, the following principles were set forth, originally regarding rapidly developing electronic commerce:

- Neutrality – concerning various forms of electronic and conventional commerce,
- Flexibility – of rules corresponding to technological changes and developments in commerce,
- Efficiency – understood as a minimalisation of compliance and administrative costs,
- Effectiveness and Fairness – the necessity of proportionate balancing tax avoidance preventing measures,
- Simplicity and Certainty – providence the taxpayers with a possibility to anticipate taxes and their consequences in advance.

The directives presented above are considered to still be relevant. Moreover, the further development of the abovementioned provisions was managed by the issuance of the report "Ottawa report on Electronic Commerce: Taxation Framework Conditions"[32].

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[29] OECD (2019), *Public consultation document: Global Anti-Base Erosion (GloBE) Proposal – Pillar Two*, OECD Publishing, Paris.

[30] OECD (2020), *Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy – January 2020*, OECD/G20 Inclusive Framework on BEPS, OECD, Paris, www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf [accessed 1.12.2019].

[31] OECD (1998), *Report by the Committee on Fiscal Affairs*, as presented to Ministers at the OECD Ministerial Conference, OECD Publishing, Paris.

[32] OECD (2001), *Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions*, OECD Publishing, Paris.

In 2012 digital markets were targeted by a tailored report "The Digital Economy"[33] published by The OECD Competition Committee. Its scope related to roundtable discussions held in 2011 and 2012. They addressed, among others, the matter of how economic growth is influenced by the digital economy and what the most urgent challenges are for public authorities in the domain of digital competition regulations.

In 2013 the OECD introduced a BEPS (Base erosion and profit shifting) programme. The role of the programme was to face the modern challenges of taxation. In that purpose, the document "Addressing Base Erosion and Profit Shifting" was issued[34]. The report touched upon the question of the scale of problems, based on the available data, as well as referred to global processes leading to the current situation. The OECD indicated therein important risks following the negative activities constituting the phenomenon of tax base erosion. It was also pointed out that profits shifting is one of the most fundamental among these activities.

As a background for these negative trends, maladjustment of current local and international tax rules was described. Lack of keeping pace with modern economic models based a.o. on global cross borders and the growing importance of intangible assets and technology, makes current regulations widely out-dated. In the end, it also leads to a mismatch between the place where the value is created and the place of taxation. The estimations concerning a possible revenue loss in a global corporate income tax caused by base erosion and profits shifting were between 4% and 10%[35]. The report also strongly underpinned the necessity of more precise measuring of the scale of tax erosion processes.

The OECD drew attention to the phenomenon of globalisation. Along with the increase of the global economy's comprehensiveness, the companies became more global as well. The concept of Multinational enterprises (MNE) easily operating around the world and carrying cross-border activities is evoked as a growing business model. Globalisation has resulted in a shift from country-specific operating models to global models based on matrix management organisations and integrated supply chains that centralise several functions at a regional or global level[36].

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33 OECD (2012), *Hearings. The Digital Economy*, OECD Publishing, Paris.
34 OECD (2012), *Hearings. The Digital Economy*, OECD Publishing, Paris.
35 *Ibid.*
36 *Ibid.*

With the growing importance of the service sector and the digitalisation of products and their delivery, many companies can perform productive activities in places unrelated to the physical presence of their clients. The link between this phenomenon and the tightening of aggressive tax planning of MNEs was indicated.

According to the organisation, negative activities conducted by MNEs also contribute to a significant increase in the pursuit of tax fairness among citizens. It was pointed out that to a large extent individual taxpayers indirectly face the burden of tax shifts committed by MNEs. Small and medium companies, without having possibilities to take similar actions of profits shifting, are equally concerned by the process.

Finally, MNEs themselves may feel the negative consequences associated with the social perception of the injustice being connected to their activities and affecting their image. For national governments, the issue to be dealt with includes the integrity of the tax system, accompanied by fewer tax revenues and higher cost of compliance processes.

The OECD also evokes certain characteristics of the digital economy: strong intangible assets reliance, data usage, value capturing from externalities generated by free products, difficulty in determination of jurisdiction proper for the value creation.

The practice of sovereign states to date in the field of international cooperation was severely limited and primarily focused on the problems of combating double taxation. The tax provisions are primarily subject to the regulatory freedom of individual countries. Thus, at the international level, the regulatory matter is forcibly associated with gaps and inconsistencies. It is worth noting that the OECD places a strong emphasis on the need to search for integrated actions at the international level. It was argued that in a situation where countries begin to regulate matters individually, the risks associated with double taxation would increase significantly. This conclusion was also reflected in the G20 leaders' declaration at the time[37].

Subsequently, the OECD published an Action Plan on Base Erosion and Profit Shifting (BEPS)[38]. The document was adopted along with the

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37 OECD (2013), *Tax Annex G20 Leaders Declaration*, St. Petersburg.

38 OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing, Paris.

G20 group. The project aimed to holistically develop 15 actions that would enable meeting the challenges faced by the international tax system. The Action Plan was constructed based on the following three principles:

1) Improving the consistency of national regulations,
2) Strengthening the provisions guaranteeing realignment of the place of taxation with the place of value creation,
3) Increasing legal certainty and transparency.

The report provided for the following actions to take:

- Action 1: Address the tax challenges of the digital economy,
- Action 2: Neutralise the effects of hybrid mismatch arrangements. This point indicates, among others, the need to change the OECD Model Tax Convention and national legislations,
- Action 3: Strengthening controlled foreign company rules,
- Action 4: The use of interest deductions and other financial payments to limit base erosion,
- Action 5: Counter harmful tax practices more effectively, taking into account transparency and substance,
- Action 6: Prevent treaty abuse,
- Action 7: Prevent the artificial avoidance of Permanent Establishment status,
- Actions 8–10: Assure the transfer pricing outcomes are in line with value creation,
- Action 11: Establish methodologies to collect and analyse data on BEPS and the actions to address it,
- Action 12: Require taxpayers to disclose their aggressive tax planning arrangements,
- Action 13: Re-examine transfer pricing documentation,
- Action 14: Make dispute resolution mechanisms more effective,
- Action 15: Develop a multilateral instrument[39].

From the perspective of the digital economy, the most important direct impact was given by a dedicated Action 1. Among the matters to be examined, the following issues were indicated:

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[39] *Ibid.*

- ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules,
- attribution of the value created from the generation of marketable location-relevant data through the use of digital products and services,
- characterisation of income derived from new business models[40].

For the following years, the OECD and the G20 members worked accordingly to implement provisions of the project. Many developing countries and international institutions were involved, such as the United Nations, the European Commission, the International Monetary Fund and the World Bank.

By 2015, the package of measures addressing BEPS was created. In October 2015 the OECD published "Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report"[41]. The most significant features of digitalisation affecting global tax policy were determined. It included, among others, the way business models change by the development of multi-sided platforms or the consequences of data usage.

In the domain of direct tax, three options were submitted to be analysed by The Task Force on the Digital Economy (TFDE)[42]:

- a new nexus rule in the form of a "significant economic presence" test,
- a withholding tax which could be applied to certain types of digital transactions, and
- an equalisation levy, intended to address a disparity in tax treatment between foreign and domestic businesses where the foreign business had a sufficient economic presence in the jurisdiction[43].

No direct recommendation was stated towards any of the aforementioned ideas. However, the conclusions of the report provided countries with the possibility to implement these solutions into national legal

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[40] *Ibid*.

[41] OECD (2015), *Addressing the Tax Challenges of the Digital Economy: Action 1 – 2015 Final Report*, OECD Publishing, Paris.

[42] The Task Force on the Digital Economy (TFDE) is a subsidiary body of the OECD's Committee on Fiscal Affairs in its Inclusive Framework format established in September 2013. The TFDE consults extensively with stakeholders from business, civil society, and academia. It led the development of the 2015 BEPS Action 1 Report and the 2018 Interim Report on the tax challenges arising from digitalisation.

[43] OECD (2015), *Addressing the Tax Challenges of the Digital Economy: Action 1 – 2015 Final Report*, OECD Publishing, Paris.

systems to combat BEPS activities. It is also worth mentioning that a big deal of attention was paid to indirect taxation issues. Especially, it concerned the growing volume of cross-border online sales and the consequences they bring for taxes, mostly VAT. In this aspect, the level playing field was projected by implementing necessary measures, intended to strengthen tax collection capacities provided in a place of customer's location[44].

The document rightly indicates that it is not possible to completely separate the digital economy and other parts of the conventional economy under legal regulations, due to the strong interconnection between both areas. The digital economy by its nature affects an increasing number of economic sectors. Solutions tackling the general phenomenon of digitalisation should be looked for, rather than those pointing at a selected group of enterprises considered to be "digital". At this point, the G20 postulated the introduction by the OECD of the so called Inclusive Framework, giving the non-G20 states the possibility to involve in the discussion[45].

Followingly, on 7 June 2017, "The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting"[46] (MLI) was signed. It provided countries with possibilities of putting into effect BEPS programme provisions by adjusting bilateral tax treaties. Minimum standards set forth by BEPS development were reflected, while the treaty empowered signatories to introduce further BEPS measures as well.

The G20 countries came out in 2017 with the initiative that TFDE would develop a report stating to what extend modern tax rules are capable of meeting the challenges of digitalisation[47]. It led to the issuance of "Tax Challenges Arising from Digitalisation – Interim Report 2018"[48].

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44 *Ibid.*

45 The Inclusive Framework on BEPS was established In June 2016. Apart from controlling and supporting the proper implementation of BEPS, its task was to work on further projects and further challenges for tax systems in connection with the digitalisation of the economy.

46 OECD (2016), *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, OECD Publishing, Paris.

47 The request was made at 2017 G20 meeting in Baden Baden in Germany.

48 OECD (2018), *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

Based on the provisions of the Action 1 Report[49] various digitalised business models were analysed along with capturing how the value creation takes place, as well as digital market specifications. As a conclusion, three characteristics of digitalised businesses were formulated in the interim report:

- international presence on a huge scale, often unrelated to physical presence,
- intangible assets reliance, including Intellectual property rights associated with allocating significant funds for further development in this area,
- strong influence of user participation and data provided by them on creating business models and value.

Consecutively, a reference was made to the discussion about the extent to which the above-mentioned characteristics actually affect tax regulations. In the first and second cases, there was an agreement among the members of the Inclusive Framework as to their occurrence and significance, accompanied by various concepts of possible regulations. About the third case, there was no consensus, and the opinions of the singular states varied[50].

The precise differences between digital and non-digital markets were also referred to. Relating to the prevailing views on the subject, it pointed out features indicating the basic differences between them:

- Direct network effects: In digital markets, utility from the consumption of a specific good or service is often dependent on the number of other end-users consuming the same good or service. This effect is called a direct network externality, sometimes also referred to as a direct network effect or consumption externality.
- Indirect network effects: In contrast to direct network effects, indirect network effects arise in the context of multi-sided markets. They occur when a specific group of end-users (e.g., users of a social network) benefit from interacting with another group of end-users (e.g., advertisers on a social network), for instance, via an online platform.

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[49] OECD (2015), *Addressing the Tax Challenges of the Digital Economy: Action 1 – 2015 Final Report*, OECD Publishing, Paris.

[50] It was raised that it would be important to examine the correlation between the level of digitalisation and user participation since the letter also occurs in many non-digitalised sectors.

- Economies of scale: In many cases, the production of digital goods and services entails relatively higher fixed costs and lower variable costs. While in many cases marginal costs will remain non-negligible, there is also a range of non-rival consumption goods, such as software, e-books or music, which can be reproduced at an effective marginal cost of zero.
- Switching costs and lock-in effects: Digital transactions can be carried out on different electronic devices; however, end-user devices often rely on different operating systems. As a result, customers may be locked-in to a particular operating system once they have acquired a specific device. Social media or email services provide a good example as a change from one application to another entails the transfer of a wide range of personal data and contacts; another example would be a change from a specific smartphone (including the operating system) to another, implying a loss in access to previously accumulated applications and data.
- Complementarity: Many of the goods and services traded in digital markets are complements; that is to say, customers derive more utility from consuming two (or more) complementary goods together. For instance, utility from using a laptop or smartphone is greatly increased when it is used together with corresponding software programs, e.g., operating systems, applications or games. Similarly, utility from spending time on a social media platform is increased when the user also has a smartphone with a range of applications allowing him or her to share more content[51].

While the indicated elements are present to some extent in both markets, their intensity and significance in the case of the digital economy acquire special importance.

Finally, to present the type of activity in question more closely and create opportunities to refer to tax-related threads, four basic sorts of digital business models were presented.

[51] OECD (2018), *Interim Report…*

Table 1. four basic types of digital business models by the OECD

Business model	Explanations	Examples
Multi-sided platforms	Platforms that allow end-users to exchange and transact while leaving control rights and liabilities towards customers mostly with the supplier; end-users affiliate with the platform and interact across market sides so that indirect networks become crucial	Uber, Didi Chuxing, Airbnb, Xiaozhu, BlaBlaCar, Weibo, Amazon Marketplace, Taobao, Facebook, NetEase or Google, Deliveroo, Foodora, UberEATS.
Resellers	Businesses that acquire products, including control rights, from suppliers and resell them to buyers; resellers control prices and assume liability towards customers; they do not allow for the interaction of end-users and they do not necessarily require customers to affiliate to the online platform	Amazon e-commerce, Alibaba, JD.com, Spotify, Tencent's music distribution, or Netflix (where it purchases content).
Vertically integrated firms	Businesses that have acquired ownership over suppliers and have, thus, integrated the supply side of the market within their business	Amazon e-commerce (warehousing and logistics), Xiaomi (end-user devices and applications), Huawei (hardware and cloud computing), Netflix (film production)
Input suppliers	businesses or individuals supplying intermediary inputs required for a production process of goods or services in another firm. In contrast to multisided platforms, input suppliers are not intermediaries and interact only with the other firm and not with the final customer	Intel or Tsinghua Unigroup

Source: OECD (2018), *Interim Report…*

Based on digital activity analysis, the report indicated two rules, fundamental for the current global tax system, crucial from the perspective of international activities. They should be closely revised and rethought: the nexus rule and profit allocation rules.

The first rule refers to the assignment of rights to tax a non-resident to individual jurisdictions. Presently, the rights allowing to tax business profits in a country other than the state of residence are primarily managed by the concept of the Permanent Establishment (PE). It is provided that the business can be deemed to have a PE, and thus be taxable in a given state, only if it has a certain level of physical presence[52]. Since the business model has changed significantly, nowadays it is plausible to exercise business activities with a very low level of actual presence.

The second rule is used to determine the part of the international company's (MNE's) profit which is subject to taxation in a jurisdiction. Currently, the standard rule in this respect is called arm's length, which uses the criteria of functions performed, assets used and risks assumed[53].

At the same time, the position towards possible changes held by particular countries diverged widely. The scope of opinions included some states presenting a reluctance to take any actions. Others were willing to act, while the spectrum of desirable actions varied. The third group opted for reforms applying to the whole economy more extensively, without limitation to the digital economy.

It was agreed that joint work on uniform principles is the best solution. The impact of digitalisation on nexus and profit allocation, as well as existing legal provisions in that respect would be comprehensively analysed. This task was to be completed by 2020. Additionally, there was no common agreement on interim measures. Certain countries argued that solutions adopted individually would have negative consequences. However, many states saw the need to urgently apply appropriate measures in their jurisdictions. For that reason, and to prevent the multiplication of individual solutions, the Interim Report provided guidance agreed upon by some states, to be respected in case of interim measures being introduced in a given country.

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52 According to Articles 5 of the OECD and UN Model Tax Conventions.

53 According to OECD (2017), *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, OECD Publishing, Paris.

3.
THE LATEST PROPOSALS FOR REGULATING THE DIGITAL ECONOMY

The latest stage of work pursuing the international consensus was initiated following the report issued in March 2018[54]. After the TFDE meeting in July 2018, discussions focused on two interrelated groups of problems. The first group concerned taxing rights allocation, including proposals to amend current provisions in the field of profit allocation and nexus. The second one concerned a broadly understood group of still lasting BEPS issues that remained unsettled by the time. These groups were later on referred to as the first and second pillar.

3.1. Addressing the Tax Challenges of the Digitalisation of the Economy in 2019

On 23 January 2019, the Inclusive Framework presented the document "Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note"[55] followed by "Addressing the Tax Challenges of the Digitalisation of the Economy – Public Consultations"[56]. They formulated a few proposals, based on two pillars.

The first pillar includes solutions in the field of the generally understood digitalised economy, aimed at revising the existing rules of tax rights allocation and nexus. At this point, it is noted that within the work of the Inclusive Framework, numerous solutions with very different characteristics were considered[57].

The second pillar dealt with a wider group of issues, previously introduced by BEPS. The actions were aimed at reducing profit shifting risks,

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[54] OECD (2018), *Interim Report…*

[55] OECD (2019), *Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note,* As approved by the Inclusive Framework on BEPS on 23 January 2019, OECD Publishing, Paris.

[56] OECD (2019) *Addressing the Tax Challenges of the Digitalisation of the Economy – Public Consultation…*

[57] *Ibid*, pp. 8–24.

using potential tools such as income inclusion rule, tax on base eroding payments, etc. The main goal was to create a framework enabling the so-called "taxing back" a.o. by granting to a given jurisdiction the right to tax[58].

It was agreed that cooperation and striving for agreement on both pillars were necessary at the same time. Once decided upon, the essential solutions would constitute a strong interference into the entire architecture of the global tax system, going far beyond current principles such as arm's length principle or physical presence. Making arrangements must be associated with clarity and simplicity reaching as far as possible, allowing both the taxpayers and public authorities further implementation of the necessary solutions. Besides, all changes in question would have serious consequences not only for a small group of "digital" companies but for a significant part of the market.

3.2. Pillar one

As part of the proposals for the first pillar, three concepts were presented:

1. user participation proposal,
2. marketing intangibles proposal, and
3. significant economic presence.

All of them share the main objective, namely to recognise, from different perspectives, value created by a business activity or participation in user/market jurisdictions that is not recognised in the current framework for allocating profits.[59] Whatmore, addressing both problems, i.e. nexus and profit allocation, would be realised alongside each other to achieve the highest effectiveness.

[58] Such a right appears when no other jurisdiction has benefited from its primary right for tax or in other circumstances in which effective taxation is poorly assured. For example, this may be the case for taxing profits at a very low rate; *Ibid*, 24–29.

[59] OECD (2019), *Addressing the Tax Challenges of the Digitalisation of the Economy – Public Consultation*, pp. 8–24.

3.2.1. The "user participation" proposal

The "user participation" proposal focuses on the principal role of users in the profit creation process. Based on current tax standards, profits generated in the country of user's location are often not captured there due to the lack of a "physical" component. Highly digitalised companies are frequently able to derive significant benefits from users' activities turning them into forthcoming profits, e.g. in the form of data left by users, subsequently exploited for marketing purposes.

The right number of users also serves in the process of brand building, as well as helps to achieve the so-called "critical mass" strengthening the company's position on the market. According to this proposal, the importance of the user's component is particularly vital in certain business models, such as social media platforms, search engines or online marketplaces[60].

Two modifications were proposed. First, the revision of the profit allocation rules to include benefits from the user base's activity located in a given jurisdiction. The physical presence of the enterprise in a given country would not matter. Secondly, the change of nexus rules would allow attributing of profits from the described activity to a given jurisdiction, enabling taxation therein. The model would be limited to companies whose profit came from such a user base[61].

The modernised profit allocation method cannot be effectively based on the arm's length principle. Due to the inability to capture the essence of the problem, i.e. user based value creation, the application of traditional methods employed in case of transfer prices is not possible. The following approach of profit allocation to a user jurisdiction was proposed:

1. Calculating the residual or non-routine profit of a business, i.e. the profits that remain after routine activities have been allocated an arm's length return.
2. Attributing a proportion of those profits to the value created by the activities of users, which could be determined through quantitative/qualitative information, or through a simple pre-agreed percentage.

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[60] *Ibid*.
[61] *Ibid*, pp. 8–11, pp. 17–19.

3. Allocating those profits between the jurisdictions in which the business has users, based on an agreed allocation metric (e.g. revenues).
4. Giving those jurisdictions a right to tax that profit, irrespective of whether the business has a taxable presence in their jurisdictions that meets the current nexus threshold[62].

To avoid disputes between countries, a formula could be introduced to help in determining the users' value and assigning users from every country to a particular business. Such a formula would be accompanied by a dispute resolution component. Simultaneously, certain challenges interconnected with this proposal were emphasised. Firstly, certain doubts arose as to whether the benefits resulting from the user based value creation process actually are created by the business, or rather the third-parties, acting in a capacity of quasi suppliers. Furthermore, the narrow scope of regulation can turn out to be a problem in the context of growing digitalisation, impacting more and more domains[63].

3.2.2. The "marketing intangibles" proposal

The second proposal also aims to change nexus and profit allocation rules. The scope of application would, however, be much wider, without limitation to digitalised businesses.

The meaning of the term "marketing intangibles" is, in this case, identical to the one used in the OECD Transfer Pricing Guidelines[64].

Furthermore, the report points out that the marketing intangible proposal addresses a situation where an MNE group can essentially "reach into" a jurisdiction, either remotely or through a limited local presence (such as an LRD[65]), to develop a user/customer base and other marketing intangibles. It sees an intrinsic functional link between marketing intangi-

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62 *Ibid*, pp. 11–12.
63 *Ibid*, pp. 18–20.
64 Marketing intangible is defined as "an intangible that relates to marketing activities, aids in the commercial exploitation of a product or service and/or has an important promotional value for the product concerned. Depending on the context, marketing intangibles may include, for example, trademarks, trade names, customer lists, customer relationships, and proprietary market and customer data that is used or aids in marketing and selling goods or services to customers". According to OECD (2017), *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, OECD Publishing, Paris, p. 30.
65 Limited Risk Distributor.

bles and the market jurisdiction[66]. Affiliation with a given jurisdiction can have a dual nature. First of all, it concerns direct benefits from intangibles, for example, the creation of a trade name or brand. Subsequently, there are secondary intangibles, such as customer data.

According to the proposal, specific regulations in the field of transfer prices and tax treaty rules would be adjusted. It enables taxation of some or all of the non-routine income in market jurisdiction being properly associated with such intangibles and affiliated risks[67].

The exemplification of the mechanisms used in this proposal was explained with three types of businesses. Firstly, in the case of a highly digitalised company benefiting from activity in a given country in which it has no tax presence. The non-routine profit derivable from the employment of marketing intangibles in a given jurisdiction would be assigned to that jurisdiction. By changing the nexus, this country would be allowed to tax the indicated profits. The second case also concerns a highly digitalised company, this time operating as LRD. The outcomes for nexus and profit allocation are successfully the same. Both these cases assure similar results to the first proposal of user participation. Finally, the third case presents a consumer product business. It cannot be classified as highly-digitalised, operates remotely or via LRD. The application also to this case constitutes the main difference between the first and the second proposal. In this approach, the activities carried out by users, as well as their engagement are deemed to be one of the intangibles. In consequence, the reach of the proposal includes a much wider scope of businesses[68].

The "marketing intangibles" approach aims to modify the rules on the distribution of benefits and nexus. The benefits of multinational businesses coming from the marketing intangibles would be attributed to the jurisdiction of these market intangibles. The same concerns the allocation of all risks that emerge[69].

The allocation can be proceeded according to one of two methods, either based on transfer pricing principles or alternative ones. The transfer pricing principles would apply in the following steps:

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66 OECD (2019), *Addressing the Tax Challenges of the Digitalisation of the Economy – Public Consultation*, p. 12.
67 *Ibid*, pp. 11–16.
68 *Ibid*, pp. 13–14.
69 *Ibid*, pp. 15–16.

1) the establishment of the marketing intangibles and determination of their contribution to the profits of the business by “current” allocation method;
2) the establishment of the marketing intangibles and determination of their contribution to the profits of the business by “profits assigning to market intangibles jurisdiction” allocation method;
3) Calculating the difference between both these methods. The difference is the “marketing intangible adjustment”[70].

A second option is a wide group of possibilities, where the allocation takes place under a revised residual profit split analysis that uses more mechanical approximations[71].

Once the sum of income derivable from marketing intangibles property is defined, the distribution criterion is used to allocate it to all market jurisdictions according to an accepted metric, for example, turnover or sales. To implement this proposal, it must be accompanied by a suitably structured dispute resolution procedure. When it comes to possible challenges, the exact nature of the “intrinsic link” and the practical application may constitute a problem in certain cases. Additionally, the equal treatment of enterprises carrying activities B2B with the ones acting B2C without the necessary distinction based on the final addressee criterium could be problematic[72].

3.2.3. The “significant economic presence” proposal

The third proposal originates from the concepts elaborated back in the 2015 Action 1 Report[73]. The basis for recognising that the company has a taxable presence in a country is still a significant economic presence. It involves cases, in which this presence is realised through sustainable and intended activities in a jurisdiction, carried by the digital technology or, alternatively, different automated means.

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[70] *Ibid*, p. 16.
[71] *Ibid*.
[72] *Ibid*, pp. 16-17.
[73] OECD (2015), *Addressing the Tax Challenges of the Digital Economy: Action 1 – 2015 Final Report*, OECD Publishing, Paris.

The nexus could be created by the revenue generated on a sustained basis combined with one of the subsequent factors:

1) the existence of a user base and the associated data input;
2) the volume of digital content derived from the jurisdiction;
3) billing and collection in local currency or with a local form of payment;
4) the maintenance of a website in a local language;
5) responsibility for the final delivery of goods to customers or the provision by the enterprise of other support services such as after-sales service or repairs and maintenance; or
6) sustained marketing and sales promotion activities, either online or otherwise, to attract customers.

The economic presence and the activity generating the revenues must be linked with each other[74].

The possible method of profits allocation could be the three-steps fractional apportionment method, originating from the Action 1 Report:

1) the definition of the tax base to be divided,
2) the determination of the allocation keys to divide that tax base, and
3) the weighting of these allocation keys[75].

Additionally, the proposal indicates, optionally, the introduction of the withholding tax[76]. Fractional apportionment, as well as the mechanism for collection on withholding, are the significant characteristics of that proposal.

Although each of these three proposals carries lots of particular characteristics, the overall actions aiming to seek the final consensus are desirable. For that reason, possible actions may include the option of further picking up selected elements from each of these proposals to construct the ultimate, commonly accepted one. In the end, the goal is to create a solution broadly recognised by the stakeholders involved in the OECD proceedings.

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[74] OECD (2019), *Addressing the Tax Challenges of the Digitalisation of the Economy – Public Consultation*, p. 16.

[75] OECD (2015), *Addressing the Tax Challenges of the Digital Economy: Action 1 – 2015 Final Report*, OECD Publishing, Paris, Section 7.6.2.2.

[76] Referred to as gross-basis withholding tax at a low rate on payments to an enterprise with a significant economic presence, with the enterprise having the right to file an income tax return and seek a refund if the withheld amount exceeded the enterprise's income tax liability, p. 17.

3.3. Latest provisions – three-tier profit allocation system

In the next steps, the OECD continued the project, which reflected in the publication of the following documents:

- In May 2019 Programme of Work (PoW) to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy[77];
- October 2019 – OECD (2019), Public consultation document, Secretariat Proposal for a "Unified Approach" under Pillar One[78];
- In January 2020 – Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy[79].

The PoW document contributed to the discussion by setting out the comparatist analysis of three aforesaid proposals, indicating common elements between them. The need for further reduction of options and gaps bridging was accompanied by the programme of subsequent actions, revising some of the previous plans[80].

Subsequently, two following OECD documents provided for the "Unified Approach" namely a method to facilitate progress towards consensus on Pillar One. It was built on the commonalities identified in the PoW[81]. The unified approach is designed to adapt taxing rights by taking into account new business models and thereby expand the taxing rights of market jurisdictions[82]. This is intended to restore the stability in the international tax system, supported by enhanced procedures on dispute prevention and resolution. To fulfill this task, the approach encompasses three categories of taxable profit which may be allocated to a market jurisdiction, referred to as Amount A, Amount B, and Amount C. Together, they shall constitute a so-called three-tier profit allocation system[83].

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77 OECD (2019), *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy,* OECD/G20 Inclusive Framework on BEPS, OECD, Paris.

78 OECD (2019), *Public consultation document, Secretariat Proposal for a "Unified Approach" under Pillar One,* 9 October 2019–12 November 2019, Paris.

79 OECD (2020), *Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy – January 2020,* OECD/G20 Inclusive Framework on BEPS, OECD, Paris.

80 OECD (2019), *Programme of Work…*

81 OECD (2020), *Statement*, 7.

82 Which, for some business models, is the jurisdiction where the user is located.

83 OECD (2020), *Statement,* 8ff.

Amount A offers the idea to allocate a portion of the residual profits of a business to market jurisdictions. It represents a share of residual profit allocated to market jurisdictions using a formulaic approach applied at an MNE group (or business line) level. The right to tax can apply irrespectively of the existence of physical presence, especially for automated digital services. It reflects profits associated with the active and sustained participation of a business in the economy of a market jurisdiction. It constitutes the primary response coming from the unified approach to the tax challenges of the digitalisation of the economy[84].

The allocated amount is over and above the arm's length return that might be allocable to in-market activities. According to the OECD, the businesses that will fall within the scope of the new taxing right under Amount A will be those that fall into the two categories: automated digital services[85] and consumer-facing businesses[86].

In order to ensure that the compliance and administrative burdens are in proportion with the intended benefits arising from this solution, the new taxing right will operate with several thresholds. First, it will be limited to MNE groups that meet a certain gross revenue threshold. Second, even for those MNE groups that meet the threshold, a further carve-out will be considered where the total aggregated in-scope revenue is less than a certain threshold. Third, consideration will be given to a carve-out for situations where the total profit to be allocated under the new taxing right would not meet a certain de minimis amount[87].

A new nexus rule will be created based on indicators of significant and sustained engagement with market jurisdictions. The regulation will be contained in a standalone rule to limit any unintended spill-over effects on other existing tax or non-tax rules. In the case of automated digitalised businesses in scope, the threshold will be the only test required to create nexus. For other in-scope activities, e.g. the sale of tangible goods, the

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84 *Ibid*.

85 As for example online search engines, social media platforms, online advertising services, digital content streaming, online gaming etc.

86 For example sale of goods and services of a type commonly sold to consumers (a. o. clothes, toiletries, cosmetics, luxury goods, branded foods and refreshments) but also personal computing products (e.g. software, home appliances, mobile phones) or franchise models, such as licensing arrangements involving the restaurant and hotel sector.

87 *Ibid*, p. 12.

proposal will not create a new nexus if the MNE is merely selling consumer goods into a market jurisdiction without a sustained interaction with the market.

When it comes to the tax base, In contrast to the traditional transfer pricing "separate entity" approach, the calculation of Amount A will be based on a measure of profit derived from the consolidated group financial accounts. Finally, the calculation of Amount A is based on a formula designed to identify the portion of the residual profits to be allocated to eligible market jurisdictions. After determining the quantum of Amount A, it will be necessary to distribute Amount A among the eligible market jurisdictions based on the pre-agreed allocation key. Finally, common and appropriate mechanisms to eliminate double taxation must be elaborated[88].

Amount B – also called "The fixed Return for Defined Baseline Distribution and Marketing Activities", referrers to fixed remuneration based on the arm's length principle (ALP) for defined baseline distribution and marketing functions that take place in the market jurisdiction[89]. Amount B aims to standardise the remuneration of distributors that buy products from related parties for resale and, in doing so, perform baseline marketing and distribution activities[90]. It proposes a fixed return to distributors that fall within this definition – a fixed return that is based on the ALP. Against this backdrop, Amount B would seek to simplify the computation of the return to activities within the scope and reduce disputes and uncertainty about the pricing of certain types of distribution activities. It is expected that this fixed return model will allow tax administrations and taxpayers to make more efficient use of resources, focusing on high-risk cases with the potential to raise substantial tax revenue. The expectation is that treaty changes will not be required to implement the Amount B regime, which should simplify the execution. The Amount B regime is rather expected to be in accordance with the ALP. The existing treaty provisions should suffice to support its adoption.

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88 *Ibid*, p. 14.

89 *Ibid*, p. 16.

90 OECD precises that "The definition of baseline distribution activities will likely include distribution arrangements with routine levels of functionality, no ownership of intangibles and no or limited risks. Defining what entities and activities would qualify could be achieved by using a positive definition based on qualitative and quantitative factors, together with a list of activities and entities that would be out of scope. The transfer pricing distribution regimes of some countries could provide useful guidance" – *Ibid*, p. 17.

Amount C – the return under Amount C covers any additional profit where in-country functions exceed the baseline activity compensated under Amount B. The further aspect of Amount C is the emphasis it gives to the need for improved dispute resolution processes. The scope of Amount C is still being discussed and considered as a critical element in reaching an overall agreement on Pillar One.

The final elaborated issue is dispute prevention and resolution leading to tax certainty. Regarding the terms above, the dispute prevention programme focuses on elements: a new framework for dispute prevention and resolution for Amount A, as well as tax certainty and dispute prevention and resolution for Amounts B and C[91].

For example, when it comes to Amount A, the OECD indicates that it would be impractical to address potential disputes through existing bilateral dispute resolution mechanisms because they generally operate after the event has taken place. Any dispute between two jurisdictions over Amount A will likely affect the taxation of Amount A in multiple jurisdictions. Resolving them under the existing bilateral system would, therefore, require multiple mutual agreement procedures. To avoid such an outcome, the new approach would be supported by a clear, administrable and binding process for early dispute prevention.

The core of the work on tax certainty, dispute prevention and resolution for Amounts B will be to limit disputes by using fixed rates of return on baseline distribution and marketing activities. Thus disputes for Amount B are limited by the provision of clear and detailed guidance on the scope of Amount B. Further work on the development of dispute resolutions on Amount A, B and C is ongoing.

Concluding, implementation of the new approach will require changes to domestic legislation and tax treaties (when necessary) to remove existing treaty barriers. If different approaches could be envisaged to streamline the implementation of these changes, a new multilateral convention could be negotiated to establish a new multilateral framework. The purpose is to ensure that all jurisdictions can implement the unified approach consistently and at substantially the same time[92].

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91 *Ibid*, 17ff.

92 *Ibid.*

3.4. Pillar two

In January 2019, the Inclusive Framework issued a Policy Note on Addressing the Tax Challenges of the Digitalisation of the Economy[93]. Along with Pillar one, Pillar Two concerned actions were tackled.

Pillar Two (also referred to as the "GloBE" proposal) focuses on the remaining BEPS issues and seeks to develop rules that would provide jurisdictions with a right to "tax back" where other jurisdictions have not exercised their primary taxing rights or the payment is otherwise subject to low levels of effective taxation[94].

On 28–29 May 2019, the Inclusive Framework agreed on a Programme of Work (PoW) concerning Pillar Two[95]. Following that agreement, certain strategically constructive discussions were made. Nowadays, the technical tasks vis-à-vis Pillar Two are being advanced by the relevant working parties[96].

Handing out for the origin of the Pillar Two actions, one must come back to the afore-described BEPS programme. Despite provisions developed under the programme regarding the alignment of taxation with the value creation, certain vividly important aspects in question remain problematic. One of them is the problem of intangibles related profits shifting towards jurisdiction offering much lower tax rates. Although the problem is not exclusively related to the field of the digital economy, the considerable presence of intangibles in this particular field makes the regulatory matters very important.

Adhering to the guidelines established in previous years saying that the digital economy should not be ring-fenced[97] from the rest of the economy and bearing in mind the importance of the still existing problem,

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[93] OECD (2019), *Addressing the Tax Challenges of the Digitalisation of the Economy Public Consultation Document,* OECD Publishing, Paris.

[94] According to OECD (2020), *Statement*, 27.

[95] OECD (2019), *Programme of Work…*

[96] According to OECD (2020), *Statement*, 27.

[97] The importance of not treating digital economy as a separate domain found its place already in 1998 in a so called Ottawa principle of neutrality saying that "Taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce. Business decisions should be motivated by economic rather than tax considerations. Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation." OECD (1998). Later on, the principle was present in the following deliberations undertaken by the OECD in the matter of the digital economy.

two proposals were introduced: income inclusion rule and tax on base eroding payments.

The principles would be accompanied by the provisions ensuring double taxation avoidance as well as guidelines for a proper and coordinated application. The application of the principles would take place by their implementation, both into national law systems and international double tax treaties, while they remain inter-related to each other[98].

The income inclusion rule provides for the introduction of the tax on incomes of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate[99].

Followingly, the income inclusion rule would operate as a minimum tax by requiring a shareholder in a corporation to bring into account a proportionate share of the corporation's income, if that income was not subject to tax at a minimum rate. The rule would apply to any shareholder with a significant (e.g. 25%) direct or indirect ownership interest in that company and would be applied on a per jurisdiction basis. The amount of income to be included would be calculated under domestic law rules and shareholders would be entitled to claim a credit for any underlying tax paid on the attributed income, with such credits also being calculated on a jurisdiction-by-jurisdiction basis[100].

The major role of this regulation would be the tax base protection in the country where the group operates, including the parent jurisdiction. Incentives to carry the activity of profits shifting towards the group entities that are taxed below the minimum rate would be annihilated. It is important to mention that with the current CFC rules[101] this regulation carries a supplementary character.

In the case of exempt foreign branches, the income inclusion rule would operate as the switch-over rule. It would turn off the benefit of an exemption for income of a branch and replace it with the credit method where that income was subject to a low effective tax rate in the foreign jurisdiction[102]. It would only apply where countries have committed to using the exemption method in their tax treaties[103].

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98 OECD (2019), *Addressing the Tax Challenges of the Digitalisation of the Economy Public Consultation,* pp. 24–29.
99 *Ibid*, p. 25.
100 *Ibid.*
101 Controlled Foreign Corporation rules.
102 *Ibid*, p. 27.
103 OECD (2020), *Statement*, 29.

The PoW[104] provides that the inclusion rule would operate as a top-up tax to a minimum rate calculated as a fixed percentage.

The second element of the proposal is called a tax on base eroding payments. It provides for the possibility of protection from the base erosion to the source jurisdiction. It consists of two rules:

1) an undertaxed payments rule that would deny a deduction for a payment to a related party if that payment was not subject to tax at a minimum rate. The rule operates by rejecting a deduction or making an equivalent adjustment in respect of intra-group payments,
2) a subject to tax rule in tax treaties that would only grant certain treaty benefits if the item of income is sufficiently taxed in the other state[105].

These measures guarantee that the proposal would provide a broad solution to profit shifting risks. It ensures to the payer jurisdiction the protection from base eroding payments even if that payment is not brought within the charge to taxation in the hands of the underlying owners under the income inclusion rule[106].

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[104] OECD (2019), PoW, 27.

[105] OECD (2019), *Addressing the Tax Challenges of the Digitalisation of the Economy Public Consultation*, p. 27.

[106] *Ibid.*

Chapter 2

European projects and regulations on taxation of the digital economy

1. INTRODUCTION

The issues of improving fairness and efficiency of the EU tax systems, as well as challenges arising from the digitalisation have been vividly discussed in the European and international forum for many years. The characteristics of the digital economy differentiating it from non-digital one, along with the importance of the digital market and its regulation is reflected in a steadily growing number of actions taken by the European actors.

The European Parliament called for new regulations in its resolution of 16 December 2015[107]. The call was made for legislative proposals to adjust the definition of "Permanent Establishment" so it could capture the digital presence as well as to introduce a definition of a so-called "Minimum economic substance". While presenting the State of the Union in 2017, the European Commission (EC) announced a "Proposal establishing rules at EU level allowing taxation of profits generated by multinationals through the digital economy"[108] followed by the communication of 21 September 2017 "A Fair and Efficient Tax System in the European Union for the Digital Single Market"[109]. The Council adopted conclusions on the taxation of the digital economy in December 2017[110].

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107 European Parliament resolution (2015/2010(INL)) of 16 December 2015 with recommendations to the Commission on Bringing transparency, coordination and convergence to corporate tax policies in the Union, Brussels.

108 Council of the European Union (2017), Council conclusions on Responding to the challenges of taxation of profits of the digital economy, Brussels.

109 Communication from the Commission to the European Parliament and the Council, COM(2017)547 A Fair and Efficient Tax System in the European Union for the Digital Single Market, Brussels 2017.

110 Council conclusions 15445/17 on Responding to the challenges of taxation of profits of the digital economy, Brussels 2017.

From the present-day perspective, the crucial step was introduced at the beginning of 2018 by the European Commission. On 21 March 2018 the Digital Taxation package was presented. It consisted of two proposals for Council directives:

- Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services (so-called Interim tax)[111] and
- Council Directive laying down rules relating to the corporate taxation of a significant digital presence (as a long-term solution)[112].

This chapter presents some crucial analysis and initiatives undertaken at the European level leading to that moment. It also provides for the exploration of discussions, debates, and evaluations held in connection with the project, historical outskirts of it, positioning of Member States and other shareholders towards particular solutions. Furthermore, it makes references to other regulations touching upon the digital economy in the EU, comparing relevant principles and solutions adopted in Europe. Finally, it presents how the legislative process associated with the abovementioned digital taxation package looked like, what the current state of matters is and what can be expected to come forth.

Without any doubt, the European Commission plays a major role in the European process of aligning tax regulations with the economic reality of digitalisation. Highlighting the current situation and the problem of digital tax, the Commission related to its political, economic as well as legal aspects. The outline of the digital economy phenomenon and its wide-ranging European perspective was thoroughly presented in the Impact Assessment document[113], issued along with digital taxation package's directives proposals. Alongside the Impact Assessment document, the Commission issued an annex containing the results of public consultation[114].

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[111] European Commission (2018), Proposal for a Council Directive 2018/0073(CNS) on the common system of a digital services tax on revenues resulting from the provision of certain digital services, Brussels.

[112] European Commission (2018), Proposal for a Council Directive 2018/0072(CNS) laying down rules relating to the corporate taxation of a significant digital presence, Brussels.

[113] European Commission (2018), Commission Staff Working Document SWD(2018) 81 final/2 Impact Assessment Accompanying the document Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence and Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, Brussels.

[114] Annex 2: Stakeholder consultation on the document European Commission (2018), *Impact Assessment*, Brussels.

2. CHARACTERISTICS OF THE ISSUE ON TAXATION OF DIGITAL ACTIVITIES IN EUROPE

According to the analyses provided for in the Impact Assessment document[115] four business models were identified as characteristic of the digital economy:

- Online platforms providing market access. These platforms act as intermediaries. Most often, users of such a platform provide goods and services directly among each other; alternatively, a platform offers users access through e.g. subscribing against payment.
- The advertising model, which includes providing users with access to a specific service, while obtaining personal data that can later be used to target personalised ads.
- Providing users with access to certain content and services against a fee.
- E-commerce, i.e. selling products over the Internet, then physically delivered to their buyer[116].

Followingly, the difficulties associated with the taxation of digital activities were given and the reasons why they are particularly susceptible to tax avoidance tendencies.

- The place of taxation and the place where the value is created do not coincide.
- Possibility to avoid being subject to taxation in a given country due to the lack of physical presence and the associated Permanent Establishment arises. The avoidance can take various forms, e.g. acting through an intermediary, recognising the key elements of the company's activity as an ancillary, the place of negotiation and the place of concluding the contracts do not coincide, classifying the given type of activity as being subject to exclusion[117].
- Using the intangible form of assets to transfer profits to other jurisdictions, even when the PE has been established. Determining the value

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[115] European Commission (2018), *Impact Assessment*.

[116] *Ibid*, pp. 15–16.

[117] For example, in order to sell goods in a given country, the company operates only through the storehouse located therein, from which it delivers goods or services.

of such assets, objectively correct from the transfer price regulations perspective, can be very difficult[118].

According to the Commission, the current situation poses a threat to competition on the Single Market between traditional business models and digital ones, with companies using aggressive tax planning and profiting from it. It is a negative factor that reduces sustainability in Member States' public finances. This fact, in its turn, influences the shifting of the tax burden to other taxpayers, and thus a disturbance of the social sense of justice[119]. It was observed that digital companies in Europe take advantage of social benefits such as well-developed education, IT skills of users, guarantees of fundamental rights and the rule of law.

Since a growing part of the whole economy acquires digital features, the natural consequence should be a proportional tax burden for enterprises possessing such digital characteristics as it is in the case of conventional ones. The digital sector should also take on a proportional burden to finance public needs through tax contributions[120].

The Commission accentuated that the need to establish regulations at the European level is also influenced by the threat of legislative fragmentation, once the states start regulating the issues on their own. This is particularly important in the light of other tax provisions, currently in the course of the legislative process. They strive to bring the European tax systems closer, making it easier for businesses to cope with it and for tax administration to optimise the combat against negative tax phenomenons[121]. In this context, the introduction of a multitude of solutions in the field of the digital economy and, consequently, their inconsistency with the other intended initiatives, significantly reduces their chances of success[122].

EC strongly referred to problems indicated by OECD reports. The Commission assured that it carefully monitors the work at the OECD level to make sure that the European approach is synchronised as much as possible. It is also pointed out that there is a very far-reaching agreement on the problem analysis as well as the most promising directions for solutions.

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118 *Ibid*, pp. 16–20.

119 Recent estimates by Tørsløv, et al. (2017) show that the aggregated loss to tax havens for Germany, France, Italy and Spain would reach over EUR 40 billion per year; see Figure 4 in Annex 7 to European Commission (2018), *Impact Assessment*.

120 *Ibid*, pp. 18–19.

121 It refers to i.e. CCTB and CCCTB projects.

122 *Ibid*, pp. 19–20.

At the same time, the need for immediate action at the European level was prompted.

To support that position, the Commission evoked the negative consequences that further postponing could cause, i.e possible loss of competitiveness or little probability of any harmonisation once local and singular regulations are in place[123]. While referring to the work on the OECD Forum, the EC indicates the progress that is being made. At the same time, it highlights that the process of change is very long-lasting and reaching an agreement may require a considerable amount of time. From this point of view, a pan-European solution would, on the one hand, be a tool for regulating the problem, on the other hand, could be used to strengthen the position presented by Europe in further global discussions[124].

3.
PUBLIC CONSULTATIONS OF THE EUROPEAN PROPOSALS FOR THE DIGITAL TAX

One of the elements constituting the mandate of the European institutions to work on digital activities taxation projects were voices from various stakeholders all over Europe. According to the digital tax project supporters, the reason to act and initiate interim reforms was the strong feeling related to the tax inadequacy in the current system. Whatmore, considering the course of the legislative process in the European Union, an important and worth mentioning stage is public consultations. Numerous stakeholders had the opportunity to refer to both the scale of the phenomenon, as well as to provide opinions on the necessity for action.

The consultation participants consisted of three groups: Tax administrations, businesses and citizens. Besides, the Platform for Tax Good Governance was also an important contributor. The main activities are open public consultation and the Member States' questionnaire from Tax

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123 *Ibid*, p. 6.
124 *Ibid*, pp. 5-6.

administrations from all over the European Union. The most important results and conclusions are presented below.

Table 2. Stakeholder consultation on the European Commission digital tax proposals

Statement	% of respondents who agreed	% of respondents who disagreed
The current international taxation rules do not allow for fair competition between traditional and digital companies.	65	20
The current situation could push some Member States toward adopting uncoordinated measures that would lead to the fragmentation of the Single market.	82	6
The current international taxation rules allow digital companies to benefit from certain tax regimes and push down their tax contributions.	73	15
States are not able to collect taxes on the value that some digital companies create on their territory.	67	18
Social fairness is impacted because some digital companies do not pay their fair share of taxes	67	18

Source: Annex 2: Stakeholder consultation on the document European Commission (2018), *Impact Assessment*.

As the main challenges posed by the digital economy on business, the participants indicated:

- Uncertainty of tax obligations in case of carrying on the activities in various countries (63% chose it),
- Uncertainty concerning the jurisdictional allocation of the value created (61%),
- Uncertainty of how the new business models shall be taxed in the future (44%)[125].

Amongst challenges posed by the digital economy on national tax systems, the most often selected were:

- National markets accessibility without the necessity to be taxed in the country (64%),

[125] Annex 2: Stakeholder consultation on the document European Commission (2018), *Impact Assessment*, p. 87.

– Cross-border businesses are offered unjust advantages over local businesses by the possibility of being taxed lower (61%),
– The complexity of the value chain renders the establishment of tax liability difficult (55%)[126].

As an overall conclusion, 82% (constituted of 366 replies) stated that in respect to prevailing international tax rules concerning the digital economy "something should be done"[127].

Afterward, representatives of tax administrations from the European Union countries were asked to express their position on the five statements. The following results were obtained.

Table 3. The results of Member States consultation on the European Commission digital tax proposals

Statement	Number of countries that agreed	Number of countries that disagreed	Number of countries neutral/ of no opinion
The current international taxation rules do not allow for fair competition between traditional and digital companies.	13	8	
The current situation could push some Member States toward adopting uncoordinated measures that would lead to the fragmentation of the Single Market.	15	1	4
The current international taxation rules allow digital companies to benefit from certain tax regimes and push down their tax contributions.	14	1	6
States are not able to collect taxes on the value that some digital companies create on their territory.	15	2	4
Social fairness is impacted because some digital companies do not pay their fair share of taxes	14	2	5

Source: Annex 2: Stakeholder consultation on the document European Commission (2018), *Impact Assessment*.

[126] *Ibid*, p. 88.
[127] *Ibid*.

Finally, 16 states expressed the support for the statement that "something should be done" while 5 countries remained neutral[128].

It was noteworthy how the Member States answered the question on which forum appropriate tax regulations in the field of the digital economy should be introduced. Out of 21, only one state declared that the right place to regulate these problems is the EU forum in the scope of the Single Market. The others pointed to the necessity of broader international level regulations[129].

As the main challenges posed by the digital economy for businesses and national tax systems the following were indicated:

- Extracting users' personal data and creating a profit on their basis (chosen by 13 States).
- The uncertainty associated with the correct attribution of value created to the relevant tax jurisdiction (13 States).
- Unclear tax situation that appears in the case of companies operating in several countries (12 States).

Amongst challenges posed by the digital economy on national tax systems, the options most often selected were:

- The complexity of the value chain renders the establishment of tax liability difficult (15 States).
- Lack of proper taxation for the newly created sources of revenues i.e. data (14 States).
- National markets' accessibility without the necessity to be taxed in the country (10 States)[130].

The results presented above are of multi-dimensional significance and cannot be underestimated. First of all, the social perception presented by entities that were surveyed translates into legal actions undertaken on the European level as well as a widely understood multinational level. These opinions come either from the entities responsible for creating law at the national level (Member States) or from actors influencing this process (citizens, tax administration bodies). In this context, it is not surprising that we witness the mushrooming of national regulations throughout the Member State[131].

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[128] *Ibid*, p. 92.
[129] *Ibid*.
[130] *Ibid*, p. 92, 93.
[131] More about this matter in the subsequent chapter.

At the same time, bearing in mind that the research was conducted on a wide group of respondents, it can be concluded that the presented dilemmas are common to many actors on the European scene. This fact, combined with general support for international regulations and significant perception of threats resulting from the high level of regulatory fragmentation, gives an important mandate for action to other organisations, e.g. the OECD.

4. THE IDEA OF THE EUROPEAN INTERIM TAX ON THE DIGITAL ECONOMY

On 21 March 2018 the Digital Taxation package was presented. It consisted of two proposals for Council directives:

– Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital (so-called interim tax)[132] and
– Council Directive laying down rules relating to the corporate taxation of a significant digital presence (as a long-term solution)[133].

The Package mentioned above also included:

– Communication from EC to the European Parliament and the Council entitled "Time to establish a modern, fair and efficient taxation standard for the digital economy" and[134]
– Recommendation of the European Commission relating to the corporate taxation of a significant digital presence[135].

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132 European Commission (2018), Proposal for a Council Directive 2018/0073(CNS) on the common system of a digital services tax on revenues resulting from the provision of certain digital services, Brussels.

133 European Commission (2018), Proposal for a Council Directive 2018/0072(CNS) laying down rules relating to the corporate taxation of a significant digital presence, Brussels.

134 Communication from the Commission to the European Parliament and the Council COM(2018) 146 final "Time to establish a modern, fair and efficient taxation standard for the digital economy", Brussels.

135 Commission Recommendation C (2018) 1650 final relating to the corporate taxation of a significant digital presence, Brussels.

Hereunder the author discusses the most important issues related to both proposals.

4.1. Interim digital tax characteristics and model solutions

The general idea of the interim tax was to target the most urgent loopholes and gaps in current rules on taxation of digital activities. It was described as a temporary solution enabling the group of activities that are presently not effectively taxed, to start generating revenues for the Member States in a short time. Revenues to which interim tax would apply are the ones being hardest to capture with current tax rules. They are created from activities in respect to which a major role in the process of value creation is played by users. The possible collection of revenues in the Member States would happen according to the location of a user[136].

The main reason for the interim tax, apart from the current disproportion between legal regulations and modern economic activities, was a very rapid development of the digital sector. Referring to the forecasts regarding the increase in revenues from digital markets, such as online advertisement, digital media or online travel, an annual increase of 6% to even 17% was indicated[137]. On that ground, the principle of interim tax was an equal application to resident and non-resident businesses as well as to both domestic and cross-border businesses[138].

The burden of the interim tax would rest primarily on the user contribution element, which is currently not properly taken into account when allocating profits. The general rule for determining whether an activity can be considered taxable depends on whether it would exist in the unchanged form without the user contribution. User participation can be active (i.e. online research) or passive (sharing certain content).

Additionally, one can point to the phenomenon of network effects, i.e. the increase in the marketing value of an enterprise due to the increase in the network of its users. User contribution is the core of many business models, e.g. the sale of space for advertisement or the sale of user data[139].

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136 *Ibid*, p. 72, p. 78.

137 Statista Digital Economy Outlook 2017 quoted in European Commission (2018), *Impact Assessment*, p. 60.

138 European Commission (2018), *Impact Assessment*, p. 60.

139 European Commission (2018), *Impact Assessment*, pp. 60–65.

Three scenarios for the interim tax were taken into account, the characteristics of which are presented in the table below.

Table 4. Three scenarios for the Interim Tax considered by the Commission

Option	Revenue threshold(s)	Rate	Allocation of tax	Double tax relief	Collection of the tax
Broad application, revenues from social media/ advertising model, intermediary platforms and digital content/ solutions	No threshold	1%	Based on the distribution of users.	No deduction from the corporate income tax base.	Tax withheld by customers or intermediaries, based on individual digital transaction
Narrow application, i.e. limited to social media/advertising model and intermediary platforms	Application of a general revenue threshold Y/N and level	3%	Based on the distribution of revenue.	Deduction from the corporate income tax base	Tax paid by companies on aggregate gross revenues from the relevant services, using a self-declaration system. For non-resident companies, possible administration administered via a one-stop shop
Mixed application which includes social media/ advertising model, intermediary platforms and some of digital content/ solution services	Application of a specific threshold on revenues from re-levant digital services Y/N and level	5%			

Source: European Commission (2018), *Impact Assessment*, pp. 59–60.

It was decided that the narrow application would be the most appropriate as a temporary solution. Its economic impact and influence on tax fairness was to be as effective as the third solution. Due to the simple concept and clear interconnection between taxation and user contribution, this proposal also involves the lowest compliance costs for businesses.

The first option was considered too broad, not satisfying the needs of the temporary nature of the project[140].

4.2. Tax threshold

As for the threshold, it was decided to establish it, in that way to limit the scope of regulations to large companies that are currently more likely to conduct aggressive tax planning. They were also identified as being responsible for blocking the possibility of development for smaller players. Trends in this area, including the biggest players purchasing their market competitors, may ultimately contribute to the weakening of innovation growth[141].

In this context, it was important to determine whether the threshold on all revenues or exclusively on those from relevant digital services should be taken as a reference point. The decision was made to include both of them, each playing a separate role. The threshold on all revenues would be applied first, narrowing the original circle of taxpayers. Then, the threshold on turnover from relevant digital services would reject, among others, businesses whose activity in the digital sector is too small, regardless of their activity in traditional sectors of the economy[142].

When setting the global threshold, EC pointed to an analysis of its impact on elements as the burden of taxpayers, the amount of final revenue collected and ensuring level playing field in the single market. EUR 750 million was indicated as the final amount. The analysis presents the accuracy of the effectiveness of this threshold. For example, with the application of EUR 500 million, the number of entities covered by the regulation would more than double, bringing only a 7% increase in revenues. At the threshold of 50 million, the number of taxpayers would increase more than threefold, while revenues would increase by about 25%. Attempts were also made to balance the threat that the interim solution would be considered discriminatory by imposing a tax on non-European companies (the largest on the market)[143].

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140 *Ibid*, pp. 65–66.
141 *Ibid*, p. 66.
142 *Ibid*, p. 67.
143 *Ibid*, pp. 67–69.

4.3. Tax rate

Referring to the tax rate, CJEU jurisprudence was cited. It creates the need for uniformity of the rate for the entire EU due to the incompatibility of the significant progression of tax rates with freedom of establishment[144]. The two factors primarily taken into account were potential tax revenues and the extent to which the tax would burden the companies.

The table below presents top-down revenue estimates for a tax on gross revenue for the EU-28.

Table 5. Tax rate

Activity	Advertising	Marketplace/ intermediaries	Cloud services*	Digital media
Tax rate 1% estimated revenues Top down scenario in EUR Billion	0.3	1.3	0.3	0.1
Tax rate 3% estimated revenues Top down scenario in EUR Billion	0.8	3.9	0.9	0.4
Tax rate 5% estimated revenues Top down scenario in EUR Billion	1.3	6.5	1.4	0.6

* Cloud services and digital media are not within the scope.
Notes: Estimates are based on a global revenue threshold of EUR 750 million and corporate income tax collected in EU-28 in 2015 of 2.5% of GDP.
Source: European Commission, own computations quoted in European Commission (2018), *Impact Assessmen*t, pp. 70–71.

4.4. Allocation of the tax

The allocation system refers to assigning tax base to each jurisdiction in the appropriate amount. For that purpose, the key based on the distribution of users instead of the distribution of revenue was set. Otherwise, the participation of users in the profit creation process would not be taken into account in many cases. At the same time, it attempted to capture the moment and method of actual profit creation resulting from the nature of diverse digital services[145].

[144] CJEU judgment of 5 February 2014, Hervis Sport, C-385/12, ECLI:EU:C:2014:47.
[145] European Commission (2018), *Impact Assessment*, pp. 72–73.

To avoid potential problems related to non-compliance with international double taxation regulations, digital tax deduction against the base of the corporate tax was allowed (relief of double taxation). The amount of tax paid would be a business expense deductible against the corporate tax[146].

4.5. Tax collection

When it comes to the collection of the tax, two potential methods were considered: withholding the tax on payments and the self-declaration system. The first one, despite the relatively high transparency and easy calculation, can create a practical problem, for example, when the user and transaction payer is not the same person. Whatmore, the inclusion of business models based on indirect profit creation would be difficult to apprehend. The second solution was chosen, the technical and legal mechanisms of which are very similar to those applicable to VAT regulations[147].

Despite the tax being classified into the indirect tax group, the EC pointed out that cascading, a phenomenon characteristic of VAT, is not expected to be excessive. It is determined by both the limited scope of taxation and directing the tax towards businesses with a huge base of users. Solely the advertisement activities were evoked as a category in which the phenomenon could occur more abundantly[148].

An additional activity imposed on businesses would be to take to necessary actions to identify and report revenues, taking into account the division into sources – from digital services and non-digital services[149]. Finally, the collection of information about users' data and their activities must comply with the protection of personal data, in particular with GDPR provisions, according to European regulations[150].

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146 *Ibid*, p. 57.
147 *Ibid*, p. 59.
148 *Ibid*, p. 56, p. 74.
149 *Ibid*, p. 76.
150 Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation), Brussels.

The expected compliance costs that both tax authorities and taxpayers would bear were expected to be at a relatively low level due to, among others, a simple tax structure. The additional challenge is the issue of current non-resident taxpayers, whom the introduction of the tax obliges to make new commitments. As a solution in this area, usage of the concept called a one-stop-shop model was indicated, enabling registration, declaration, and payment of tax due in several offices through one of them[151].

4.6. Final digital interim tax project and further amendments

Article 113 of the Treaty on the Functioning of the European Union was indicated as the legal basis for interim tax[152].

According to the final and official proposal presented by the Commission, the interim tax would apply to revenues created from activities, such as revenues:

1) created from selling online advertising space,
2) created from digital intermediary activities that allow users to interact with other users and which can facilitate the sale of goods and services between them,
3) created from the sale of data generated from user-provided information[153].

The threshold of the application was the total annual worldwide revenues of EUR 750 million and EU taxable revenues of EUR 50 million for a company[154]. It was pointed out that from a legal point of view the tax would be treated as indirect, other than turnover taxes and different from excise duties[155].

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151 European Commission (2018), *Impact Assessment*, pp. 76–77, p. 79.

152 It says "The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition".

153 Based on European Commission (2018), Proposal for a Council Directive 2018/0073(CNS), Article 3.

154 *Ibid*, Article 4.

155 European Commission (2018), *Impact Assessment*, p. 20. This fact will have significant consequences in further national legislation modelled on the proposals of the European Commission. More information on this subject is provided in the following chapter.

While explaining the proposal, EC indicated that a quick action was crucial to avoid unilateral measures of taxation of digital activities in the particular Member States. Actions potentially leading to a patchwork of national responses would have a damaging influence over Single Market[156]. The interim solution would apply only by the time of implementing a comprehensive international reform in this domain[157].

Following the original legislative proposal, interim tax was subject to further discussions. In December 2018 the European Parliament set forth some propositions adjusting the project, among others:

– to lower the threshold of application from EUR 50 to 40 million of taxable revenues in the EU,
– to broaden the tax base, proposing the inclusion of more activities than listed before,
– to provide the Commission with a capacity to evaluate the level of revenues generated by the tax within two years of the entry into force of the directive,
– to request the Commission to examine the possible establishment of a dispute-resolution mechanism for cases of disagreement on the allocation of taxable revenues among the Member States,
– to establish a country-by-country reporting system concerning total digital service tax paid per Member State by a taxable person,
– to introduce a sunset clause specifying the expiration time for interim tax[158].

In case no comprehensive solution is to be agreed by 31 December 2020, the Parliament asked the Commission to consider presenting a proposal based on Article 116 TFEU, which provides for the ordinary legislative procedure to be used[159].

Two years after the date of entry into force of the directive, the Commission should assess its application and present a report to the European Parliament and the Council. The Commission should focus then on the possibility of increasing the tax rate from 3% to 5%, on the scope and the amount of tax collected, and on the methods used by com-

[156] European Commission (2018), Proposal for a Council Directive 2018/0073(CNS), 3ff.
[157] *Ibid*, p. 5.
[158] European Parliament legislative resolution of 13 December 2018 on the proposal for a Council directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, Brussels 2018.
[159] *Ibid*.

panies to avoid the tax. Member States would report relevant figures to the Commission annually, as well as inform it on the payment of the tax, and on their cooperation with other national tax authorities[160].

Following the special legislative procedure, the proposal requires unanimity in the Council to be adopted, regarding consultation of the European Parliament. European ministers discussed the file in December 2018. It was agreed that discussions would continue at the technical level. on 12 March 2019, the Economic and Financial Affairs Council could not reach an agreement. In parallel, it was declared that the Presidency would work on the EU position in international discussions on digital tax, in particular concerning OECD's report on the issue, due by mid-2020[161].

5. LONG-TERM SOLUTION FOR EUROPE PRESENTED BY THE EUROPEAN COMMISSION

5.1. Model long-term solutions – the preliminary excluded proposals

Alike in the case of the interim solution, the European Commission succeded to profoundly analyse numerous possibilities for the long term solution.

Part of them were declared and referred to as fundamental reforms, whose exclusive application as a new general principle was rejected. The solutions and concepts developed therein were, however, used to some extent in subsequent national projects on taxation of the digital economy[162]. Since the global debate is still ongoing and certain ideas tend to resurface, it is worth to evoke them.

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[160] European Parliament legislative resolution of 13 December 2018 on the proposal for a Council directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, (COM(2018)0148 – C8-0137/2018 – 2018/0073(CNS)), Brussels 2018.

[161] According to: http://www.europarl.europa.eu/legislative-train/theme-deeper-and-fairer-internal-market-with-a-strengthened-industrial-base-taxation/file-digital-services-tax-on-revenues-from-certain-digital-tax-services [accessed 26.05.2019].

[162] As presented in the next chapter.

Among the so-called fundamental reforms proposals, one may find:

1) destination-based tax concept – a model with two characteristics. The first is an instant accounting of revenues and expenditures, at the time of related payment's execution, including capital investment expenditures. The second is granting the right to tax to a country where the consumer purchases goods and services;
2) unitary tax concept – global profits are subject to tax, proportional assignment to a particular country. Thereafter, the proportionate global profits allocated to the state are taxed in that country. The application of this concept to global digital companies would occur by separating a group of companies "providing mainly digital activities" and applying these rules to them instead of the common corporate tax rules;
3) residence tax base with destination tax rate concept – it includes compliance with current taxing rights of given countries as well as current tax base calculation methods in the country of residence. At the same time, it was assumed that the tax rate would be a weighted average of tax rates from all those countries where profit is generated. Equally to the previous proposal, this option would be an alternative to corporate tax, finding application to companies operating on "mainly digital activities"[163].

The above-mentioned proposals were considered tackling the digital challenges at their very roots. Furthermore, the entire tax system would need to be reviewed against the digital economy sector. It would become also a completely separate regulation from those provided for in the CCCTB project[164]. Due to the complexity and far-reaching innovation, these projects could face serious implementation difficulties, evoked by the Council in the conclusions issued at the end of 2017.

The Council pointed out that a globally accepted definition of permanent establishment and the related transfer pricing and profit attribution rules should remain pivotal when addressing the challenges of taxation of profits of the digital economy[165]. Hence, the Member States decided to

163 European Commission (2018), *Impact Assessment*, pp. 28–30.

164 Common Consolidated Corporate Tax Base (CCCTB) is described in the following subsection of this chapter.

165 ECOFIN Council conclusion (2017) 15175/17 on "Responding to the challenges of taxation of profits of the digital economy" quoted in European Commission (2018), *Impact Assessment*, p. 34.

take different, less revolutionary steps, remaining in the current legal framework, without changing the framework itself[166].

Consequently to the rejection of the aforesaid projects, three updated proposals were presented, lastly considered as valid options in the context of the European legislative project.

5.1.1. Model long-term solutions – first proposal

The first proposal was to adapt the rules for assigning profits to countries of the actual location of the value creation (allocation rule). This would be done through the proper provisions made under the CCCTB Directive. After meeting certain criteria, a business would be deemed to have a so-called "digital permanent establishment" in the EU. The criteria in question could relate to such aspects as:

- reaching revenues from digital activities, the value of which exceeds a certain threshold in a given Member State,
- exceeding a certain number of active users in a given country,
- surpassing a certain number of concluded contracts[167].

As part of this proposal, the profits allocating formula presented in the current CCCTB project would also be reviewed. It was pointed out that based on the criteria listed above, a fourth element could be added to the current formula to capture the digital presence of enterprises[168].

Due to the connection with the CCCTB regulation, the proposed solution would only apply to businesses with a turnover of over 750 million euros worldwide (CCCTB is obligatory for these businesses). Another consequence is that the proposal would only apply to businesses that are already tax residents in one of the EU countries.

An exception allowing to use this solution toward third countries would apply if no convention on double tax has been concluded with the third country. When adopting this principle, Member States would have to adapt separate permanent establishment regulations to digital companies and other companies. Besides, within the scope of tax obligations of digital

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166 *Ibid*.
167 European Commission (2018), *Impact Assessment*, pp. 31–32.
168 See: subsection on CCCTB.

companies, an actual stratification would be created. Larger companies fall within the scope of regulatory CCCTB, and therefore are subject to the principles contained therein regarding digital PE. Smaller digital companies to which the directive would not apply at all would operate on the current basis. In terms of the latter companies, it would also be important that this solution would discourage voluntary accession to the CCCTB, which the directive provides for smaller companies. For this reason, another variation of the project was also envisaged, wherein regulations regarding the digital permanent establishment would apply to all digital companies, not just selected ones[169].

This proposal would allow combating phenomena considered undesirable, including significant tax planning. At the same time, because of the relatively narrow group of entities subjected to taxation, the financial overtone would be rather modern.

5.1.2. Model long-term solutions – second proposal

The second proposal concerns the adoption of a separate, independent directive that would introduce the institution of digital permanent establishment as well as regulate the issue of profit allocation.

The directive would set the rules for establishing a digital permanent establishment in a given country, specifying the rules for assigning profits thereto. The fundamental principle would be the tie between the place of taxation and the actual place of profit creation. The following criteria would be taken into account:

– personal data of users from a given country collected by the digital platform,
– the number of users in a given country and the digital content they have created,
– users' contribution to the development of digital platform activities.

As in the case of the first proposal, the regulation would apply between the Member States and towards third countries in the absence of

[169] Draft European Parliament legislative resolution on the proposal for a Council directive on a Common Corporate Tax Base (COM(2016)0685 – C8-0472/2016 – 2016/0337(CNS)).

a double tax convention. A change in comparison with the first proposal is that the regulations would also apply to certain enterprises that do not meet the EUR 750 million thresholds indicated in the CCCTB directive, after fulfilling the substantive conditions indicated above. The directive would constitute a separate bill from the CCCTB. Therefore the implementation of digital companies' tax regulations would not be associated with the need to agree on CCCTB and could occur regardless of consensus or lack thereof. For this reason, the project in such a form seems to create the greatest possibilities for real action. Additionally, due to the complexity of regulation, the directive would establish a solid legal framework at European level, without giving grounds to the individual Member States for adopting singular regulations on their own. Also, regulations in this form would ensure better efficiency in the combat against undesirable tax phenomena, such as aggressive tax planning and consistent profits shifting to countries other than the one of value creation, both within and outside the EU[170].

The economic impact of this proposal is considered larger than in the case of the first one, while susceptible to grow with the development of the digital economy sector. In terms of administrative costs related to the implementation of this solution, they would rise along with the increasing scope of taxation and the creation of new legal obligations. At the same time, it was underlined that those costs would be incurred alternatively if selected countries would regulate the issue on their own in a mutually uncoordinated way. That scenario could be the consequence of the absence of pan-European regulations. In the face of such a development, compliance costs for companies would be significantly reduced once the European solution is adopted[171]. Finally, an important issue was raised about maintaining flexibility between proposals in question and upcoming solutions developed in the international forum. In this light, European regulations must remain general and flexible enough to prevail compatible with future global arrangements[172].

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[170] European Commission (2018), *Impact Assessment*, p. 40–43.
[171] *Ibid.*
[172] *Ibid.*

5.1.3. Model long-term solutions – third proposal

The third proposal in the initial form was, likewise the second one, an independent directive, which would also apply towards third countries[173]. Due to the presently applicable conventions on double taxation, it would require their renegotiation. To this end, recommendations would be issued introducing changes to the Model Tax Convention of the OECD[174]. The European Commission points out that this scenario is capturing to the greatest extent a need for a level playing field relative to businesses from all over the world. It entails the far-reaching possibilities of restoring tax fairness. However, implementing these ideas would be associated with considerable uncertainty until the renegotiation of tax treaties. Countries would be forced in part to breach and change their existing obligations concerning third countries. For this reason, an alternative version of the third proposal was also introduced[175].

The alternative version[176] implies non-mandatory but recommended action towards tax treaties with third countries. Other provisions of the proposal would remain the same.

The biggest benefit of this solution is that it covers companies that are not tax residents in Europe at the moment. In this way, taxation inequalities currently exploited by companies creating profits within the EU with no presence for tax purposes would be eliminated. It should also be noted that, compared to the solutions outlined above, there would be no incentive for companies to avoid tax residence in the EU[177].

As an ultimate decision of the Commission, the third proposal was considered to be the best. The criteria such as efficiency in achieving the indicated goals, ensuring an appropriate level of playing field and preventing negative activity regarding tax planning were taken into consideration. However, the success depends to a large extent on the efforts of the Member States themselves, to whom this option leaves actions based on the issued

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173 Called Intra-EU – wide scope + mandatory application visà-vis third countries.

174 Respectively changing article 5 and 7, implementing different regulations on Permanent Establishment and Business Profits.

175 European Commission (2018), *Impact Assessment*, 33ff.

176 Called "Realigning profit allocation rules with value creation intra-EU and recommendation to change rules vis-à-vis third countries".

177 European Commission (2018), *Impact Assessment*, 33ff.

recommendations. Also in the context of solving the digital economy tax problems at the global level and work at the OECD Forum, it was decided to choose this option[178].

Table 6. Comparison of effectiveness, efficiency, and coherence of comprehensive digital tax options elaborated by the European Commission

	Option 1 Intra-EU – narrow scope: Adjustments to the CCCTB rules	**Option 2 Intra-EU – wide scope: Directive on new permanent establishment and profit allocation principles + adjustments to the CCCTB rules**	**Option 3 Intra-EU – wide scope + recommend application visà-vis third countries**
The integrity of the Single market	Weak	Medium/Strong	Strong
Sustainability of public finances	Medium	Medium/Strong	Medium/Strong
Social fairness and level-playing field	Weak	Strong	Strong
Fight against aggressive tax planning	Medium	Medium	Medium/Strong
Economic impacts	Neutral	+	+
Admin burden and compliance costs	-	+	+
Coherence with EU and global tax agenda	Neutral	+	++

Source: Based on an analysis of the European Commission presented in European Commission (2018), *Impact Assessment,* p. 48.

Additionally, the results of public consultations showed the greatest support for the third solution.

[178] *Ibid*, pp. 49–51.

Table 7. Results of public consultations on comprehensive digital tax options elaborated by the European Commission

Option	For	Against	No opinion
Modify the Common Consolidated Corporate Tax Base proposal	44% of respondents 9 States	27% of respondents 9 States	29% of respondents 3 States
"Digital presence in the EU" proposal	58% of respondents 14 States	28% of respondents 5 states	14% of respondents 2 states
Destination-based corporate tax	54% of respondents 6 States	34% of respondents 12 states	12% of respondents 3 states
Unitary tax	50% of respondents 6 states	37% of respondents 13 States	13% of respondents 2 states
Residence tax base with destination tax rate	28% of respondents 1 state	53% of respondents 17 states	19% of respondents 3 states

Source: European Commission stakeholders consultation results presented in: European Commission (2018), *Impact Assessment*, p. 49.

5.1.4. Model long-term solutions – regulation range and threshold

The Commission indicated the necessity to set thresholds high enough so that smaller enterprises could avoid problematic compliance adjustments. For that purpose, calculations were made, including costs for enterprises related to the creation of an additional digital PE. In this domain, the tax literature postulates the flexibility of thresholds, letting it be adapted to the economic and geographical realities of individual countries[179]. At the end of the day, no such solution was decided. Taking into account the work of the OECD and other authors[180] the following three basic criteria for measurement of digital activity were identified[181]:

[179] Brauner, Y., and Pistone P. (2017), Adapting Current International Taxation to New Business Models: Two Proposals for the European Union, *Bulletin for International Taxation*, Vol. 71, No. 12.

[180] A.o. Hongler and Pistone, P. (2015*), Blueprints for a new PE Nexus to tax business income in the era of the digital economy,* IBFD Working paper, 20 January; OECD (2015), Addressing the Tax Challenges of the Digital Economy: Action 1 – 2015 Final Report, OECD Publishing, Paris.

[181] As in Article 4.3 of European Commission (2018), Proposal for a Council Directive 2018/0072(CNS).

– revenues achieved in a given country,
– number of users[182],
– number of online contracts [183].

5.1.5. Model long-term solutions – tax on revenues

A very important issue was raised regarding the calculation of tax based on revenues. This is a matter having a resonance in numerous debates on the taxation of digital activity, both at EU and OECD forums and at the national level. It was denoted that the OECD also refers to tax concepts levied on revenues in connection to all kinds of temporary solutions, for they are characterised by more efficient implantation combined with lower costs to incur[184]. Other solutions, based on direct taxation, would be hard to bring together with the existing tax framework. In the case of projects intended to be temporary, these features are considered disqualifying. The need to respect the legal framework displayed by international entities such as the WTO and the OECD as well as conventions and treaties, combined with short implementation time, require looking for other arrangements[185].

Scientific researches were also indicated in this context. They registered that if profits (not incomes) were subjected to taxation, along with a reduction in the tax rate, a significant decrease in tax evasion and an increase in tax revenues would occur. A positive impact of such a change on social welfare was also stated and justified by a significant increase in compliance with tax obligations[186].

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[182] User is defined as "any individual or business that registers, logs on or visits a company's digital platform" according to European Commission (2018). Impact Assessment, p. 45.

[183] Defined as "legally binding agreements concluded by accepting (through "clicks") the "terms of service" of the digital service provider" European Commission (2018), *Impact Assessment*, p. 45.

[184] OECD (2015), *Addressing the Tax Challenges of the Digital Economy: Action 1 – 2015 Final Report,* OECD Publishing, Paris.

[185] European Commission (2018), *Impact Assessment*, pp. 55–56.

[186] Emran, M.S., and Stiglitz, J.E. (2005), On selective indirect tax reform in developing countries, *Journal of Public Economics*, Vol. 89, pp. 599–623; Gordon, R., and Li, E. (2009), Tax structures in developing countries: Many puzzles and a possible explanation, *Journal of Public Economics*, Vol. 93, pp. 855–866; Best, M.C., Brockmeyer, A., Kleven, H.J., Spinnewijn, J. and Waseem, M. (2015), Production versus revenue efficiency with limited tax capacity: Theory and evidence from Pakistan, *Journal of Political Economy*, Vol. 123, No. 6.; France Stratégie (2015), *Taxation and the digital economy: A survey of theoretical models – Final report*, Study for France Stratégie with contributions from Bacache, M., Bloch, F., Bourreau, M., Caillaud, B., Cremer, H., Crémer, J., Demange, G., de Nijs, R., Gauthier, S. and Lozachmeur, J.-M.

5.1.6. Common EU solution for digital activities – final project

Following the considerations and decisions taken at the analytical stage described above, alongside the final interim tax, EC presented the final legislative proposal for a long-term solution[187]. According to the project, member states would be enabled to tax profits generated in their territory, even if a company does not have a physical presence there.

Such a company would be deemed to have a taxable "digital presence"[188] in a Member State if at least one of three criteria is fulfilled:

- the company's annual revenues from digital services in a Member State exceeds a threshold of EUR 7 million,
- the company has more than 100,000 users who access its digital services in a Member State in a taxable year,
- over 3000 business contracts for digital services are created between the company and business users in a taxable year, securing a factual connection between the place where digital profits are made and the ones where they are taxed[189].

A new way of profits attribution would take into account the market values of such factors as:

- profits from user data (e.g. placement of advertising),
- services connecting users (e.g. online marketplace, platforms for sharing economy),
- other digital services (e.g. subscription to streaming services)[190].

Article 115 of the Treaty on the Functioning of the EU was indicated as the legal basis for the long term solution[191].

This action would ensure the contribution of online businesses to public finances at the same level as traditional businesses. According to the EC position, in a longer time perspective, standalone directive operating independently of different tax frameworks could be integrated into the Common Consolidated Corporate Tax Base (CCCTB). For CCCTB to

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187 European Commission (2018), Proposal for a Council Directive 2018/0072(CNS.

188 So called virtual permanent establishment.

189 According to Article 4.3 of European Commission (2018), Proposal for a Council Directive 2018/0072(CNS).

190 More about it in article 5 European Commission (2018), Proposal for a Council Directive 2018/0072(CNS).

191 European Union, Consolidated version of the Treaty on the Functioning of the European Union (2008) OJ C 202, from 7 June 2016, p. 95–95.

effectively capture the digital activities of multinational companies, it should be adapted in line with the "digital" proposal in question. The Commission also emphasised compliance between the proposal and fundamental rules of the EU legal system. The solution is perceived as proportionate, not interfering with national rights to draw the line on the number of corporate tax revenues, their composition, as well as national choices in terms of the size of public sector's intervention[192].

Another important angle was the matter of potential influence that the regulations could have over double taxation treaties signed by the Member States. The application of new rules would also be relevant in cases where a Member State does not have a double taxation treaty with a third country. Sticking to the status quo, in the case where an enterprise interacting with EU users is a tax resident outside the EU, new provisions would not apply. To refrain from any interference into double taxation treaties, which remain an area of national sovereignty, the Commission issued a recommendation to the Member States, so they could take all the necessary measures[193]. In this document issued on 21 March 2018 alongside the proposal itself, EC recommended that the EU Member States make the following changes to their double tax treaties:

- to modify the definition of a "permanent establishment" to take into account situations where a company has a significant digital presence in a given country/jurisdiction;
- to include rules for how profits should be attributed to a significant digital presence, in line with the provisions proposed by the Commission[194].

According to the special legislative procedure, the proposal requires unanimity in the Council for its adoption, following consultation of the European Parliament. In July 2018 the Austrian presidency organised a conference on the taxation of the digital economy to exchange ideas. It was decided to give priority for reaching an agreement on the interim solution in the first place[195].

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192 According to European Commission (2018), *Impact Assessment*, 49ff.

193 Commission Recommendation relating to the corporate taxation of a significant digital presence (of 21.3.2018), Brussels.

194 All recommendations included in the document cited above.

195 According to: https://www.europarl.europa.eu/legislative-train/theme-economic-and-monetary-affairs-econ/file-significant-digital-presence-for-corporate-taxation [accessed 30.03.2020].

Subsequently, in December 2018 the European Parliament adopted a report on the issue. It proposed among others:

- to ensure that the concept of significant digital presence and the proposed solutions become an integral part of the directives on CCTB and CCCTB, being under discussion in the Council. The Commission would issue guidelines for tax authorities on how a significant digital presence and digital services are to be identified, measured and taxed. The Commission would also establish another set of guidelines, with a clear methodology for companies to self-assess which of their activities constitute a significant digital presence;
- to mandate the European Commission to negotiate tax treaties with third countries under the rules of the directive, particularly regarding the embodiment of the definition of a significant digital presence (EC would be mandated by the Member States);
- to ensure that small and medium-sized enterprises are not unduly taxed[196].

Also in December 2018, ministers discussed the proposal. They exchanged views on the presidency's compromise text and examined a joint declaration by the French and German delegation which proposed to limit the tax base to revenues from sales of advertisements[197]. It was agreed that discussions would continue at a technical level to explore whether a narrower scope could be accepted by the delegations[198].

On 12 March 2019, the Economic and Financial Affairs Council could not reach an agreement on the tax with a scope limited to digital advertising services. In parallel, the presidency announced further work on the EU position in international discussions on digital tax, in particular in view of OECD's report on the issue, due by mid-2020. A mission letter for the executive vice-president of the new Commission for a Europe "fit for the Digital Age" describes the mandate in this field[199].

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[196] European Parliament (2018) legislative resolution of 13 December 2018 on the proposal for a Council directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, Brussels.

[197] According to "Franco-German joint declaration on the taxation of digital companies and minimum taxation".

[198] According to Council of the European Union, (Meetings) Economic and Financial Affairs Council, 4 December 2018.

[199] According to the European Union communication "Deeper and Fairer Internal Market with a Strengthened Industrial Base / Taxation".

The Council of the European Union (ECOFIN) held a meeting on 17 May 2019 on further steps concerning the project. Ministers assessed possibilities to prepare negotiations in the OECD on the ongoing international debate on long-term comprehensive solutions addressing both the challenges of taxation in the digitalised economy and broader issues related to the allocation of taxing rights and tax competition[200]. As a result, at the end of 2019, the document called "Digital taxation – State of play" was issued[201]. It discussed the European position towards the debate taking place at the OECD level, analysed from many angles and perspectives. It also emphasised the support for the ongoing deliberations and propositions leading to a wide-reaching international agreement[202].

On 21 January 2020, another meeting of the Economic and Financial Affairs Council took place. The ministers summarised the progress accomplished at the OECD level, both on the reallocation of profits of digitalised businesses ("Pillar 1") and the general reform of international corporate taxation ("Pillar 2"). The debate confirmed that an international solution to digital taxation was the best way forward, preventing fragmentation and unilateral measures. It was acknowledged that the OECD was working to reach a global agreement by the end of 2020. Also, the importance of making good use of the current political momentum was underlined. The presidency concluded that it would continue attending international meetings on this subject and organise technical discussions in the Council to prepare, as far as possible, for negotiations taking place at the OECD and address Member States' concerns[203].

At present, the official status of the proposal remains as "waiting final decision". Since the interim tax regulation, recognised by the Council as the first challenge to meet, found troubles, the actual status of the long term project can be considered as "suspended"[204].

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200 According to: Council of the European Union (2029), *Policy overview – Digital Taxation*, Brussels.
201 Council of the European Union (2019), *Digital taxation – State of play (13405/19),* Brussels.
202 *Ibid*.
203 *Ibid*, section "Economic and Financial Affairs Council, 21 January 2020".
204 Based on: Legislative observatory of the European Parliament, https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?reference=2018/0072(CNS)&l=en [accessed 26.05.2019].

5.2. European digital tax and the Value Added Tax on digital services

Digital tax is an idea of (in)direct taxation of digital activities. Aside from the concept of creating a dedicated tax, other solutions have emerged in recent years, aimed at capturing modern business activities including digital ones. An example can be seen in certain VAT regulations in the European Union.

The importance of coexistence between solutions covering direct and indirect taxation is strongly underlined by the European Commission. Such elements as digital tax, CCCTB and digital VAT denouement should be aligned together. Additionally, certain legal institutions and solutions provided for VAT operating in the digital economy (already put into practice on the ground of VAT regulations) can be of importance for future digital direct tax. The European Commission indicated[205] that, for example, the designation of the term "digital services for the purposes of a revenue threshold" can find reflection in the currently existing definition on electronically supplied services[206], described in Article 7(1) of the VAT Implementing Regulation[207].

VAT adjustments towards modernity and digitalisation can be praised in various dimensions. They can be a strong indicator, enabling the answers for questions such as "how does the modern value creation look like? where is the value actually created and by whom? who is really the bearer of the financial and non-financial burden of the creation process?". Certain elements of the VAT regulations could be used to improve digital tax provisions. Question "how to understand, capture and measure digital presence?" is often asked in debates on digital tax. Some ideas, that have already been provided for in indirect tax regulations on VAT, can be of help.

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205 European Commission (2018), *Impact Assessment*.

206 "Electronically supplied services" include services which are delivered over the Internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology.

207 Council Implementing Regulation (EU) No 282/2011 (of 15 March 2011) laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, Brussels.

The following are briefly described selected examples of the European VAT provisions that are directly relevant to the digital economy and often inspired by it.

In 2015 a package of legislation covering telecommunications, broadcasting and electronic services entered into force. The enlisted services are taxed in the country of customer's belonging, regardless of the location of the supplier's base. The circumstances of a customer being a consumer or a business aren't taken into account. It also provided for a solution called "Mini One Stop Shop (MOSS)". According to it, businesses are permitted to fulfill only one declaration and make one payment in a given country, referring to sales from different Member States[208].

In 2016 a plan of action on VAT was published [209]. It delivered a very wide scope of measures, including the ones facing challenges of digitalisation. The ground reason for the plan was the adoption of the European VAT system to the economic reality of the 21-century. Supporting e-commerce, as well as small and medium enterprises (SMEs) are among the key elements of the plan, in line with cross-border trade regulations, fraud prevention and widening national capacities of tax rates setting. The big deal of these provisions found the reflection in further regulations, many of them strongly touching upon digital elements of the economy and common market. At that moment, the European Commission indicated that the VAT system has been unable to keep pace with the challenges of today's global, digital and mobile economy[210].

In October 2017 an announcement took place of the "October 2017 definitive VAT system package", consisting of three legal acts. Firstly, the Council directive proposal, intended to simplify and harmonise some VAT rules, touching upon the trade between the Member States[211]. The purposes were, i.e.: alignment of taxation rules for goods and services rendered

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[208] According to: European Commission Telecommunications, broadcasting & electronic services – Rules applicable since 2015 with the list of legislation included therein.

[209] European Commission (2016), Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an Action Plan on VAT Towards a single EU VAT area – Time to decide, Brussels.

[210] Based on VAT Action Plan: Commission presents measures to modernise VAT in the EU, https://europa.eu/rapid/press-release_IP-16-1022_en.htm [accessed 25.05.2020].

[211] European Commission (2017), Proposal for a Council Directive amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States, Brussels

betwixt the Member States with domestic one, VAT gap fighting, reducing business' costs of compliance actions and simplification of the system.

The other two acts implemented the notion of the certified taxable person (CTP) and the VAT information exchange system (VIES). They also set rules for receiving proof of intra-community transport for exemption purposes[212].

A further example of legal action is a legislation provided for in December 2017. It consisted of three pieces of legislation and constituted new rules for the so-called "VAT e-commerce package"[213]. It refers to any type of supplied service, where the final customers are located in the European Union. Subsequently, new rules were also adopted for distance sales of goods.

The European Commission proposed, in January 2018, to provide Member States with the more flexible capacity of setting VAT tax rates[214]. The provision, being part of the action plan mentioned before, is of importance since some voices had arisen stating that the solution replacing any digital tax whatsoever could consist of setting a higher tax rate on digital services[215]. Such a solution would not be feasible at the European level for it would be in contradiction to the VAT principles (more about it below).

In December 2018 the Commission proposed provisions aiming at simplification of VAT obligations for enterprises executing cross-border sales of goods or services, especially online ones. Provisions were to ensure the correct implementation of the destination principle as well as the correctness of payments executed in the Member State of the customer[216].

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212 European Commission (2017), Proposal for a Council Regulation amending Regulation (EU) No 904/2010 as regards the certified taxable person, Brussels; European Commission (2017) Proposal for a Council Implementing Regulation amending Implementing Regulation (EU) No 282/2011 as regards certain exemptions for intra-Community transactions, Brussels.

213 1. Council Directive (EU) 2017/2455 of 5 December 2017 amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods, Brussels.
2. Council Regulation (EU) 2017/2454 of 5 December 2017 amending Regulation (EU) No 904/2010 on administrative cooperation and combating fraud in the field of value added tax, Brussels.
3. Council Implementing Regulation (EU) 2017/2459 of 5 December 2017 amending Implementing Regulation (EU) No 282/2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, Brussels.

214 Council Directive amending Directive 2006/112/EC as regards rates of value added tax, Brussels.

215 According to the analyses provided for in European Commission (2018), *Impact Assessment*.

216 According to: European Commission, Modernising VAT for cross-border e-commerce with the list of legislation included therein.

One of the solutions raised during the debate on digital tax introduction to capture digital activity was the use of the existing VAT structure for this purpose. After consideration, the European Commission emphasised that the scope of resources for using VAT regulations to fight taxation inequality coming from the digital economy is highly limited[217].

Within the current European legal framework of VAT, lifting tax rates solely on digital services is not a solution. There is few reasons for that:

- The legal construction of this tax does not facilitate and strongly limits a real impact when it comes to B2B services. Most businesses are allowed to deduct the input of VAT.
- According to the basic principle of the VAT directive, all goods and services can be taxed only up to the standard rate; higher levy imposed solely on digital services would breach that rule. Furthermore, exclusively one standard rate can be set up by each Member State. The possible infringement of the principle of fiscal neutrality can also be pondered when the same services are submitted to higher or lower taxation, simply depending on the digital or not-digital way of supply[218].

One must notice that the Council Directive proposal on amending VAT Directive rather seems to reflect different tendencies by strengthening the national ability to set the rates of value-added tax. According to it, bigger freedom shall be given to the Member States when it comes to establishing tax rates[219].

5.3. European digital tax proposals – compliance with the Value Added Tax Directive

Another important issue is the European digital tax compliance with VAT and since the tax also refers to turnover, problems might arise[220]. Article 401 of the VAT General Directive[221] does not preclude introducing and maintaining taxes, under the condition that they will not be characte-

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217 Based on analyses presented in European Commission (2018) Impact Assessment.

218 European Commission analyses in relation to Council Directive 2006/112/EC (of 28 November 2006) on the common system of value added tax, Brussels

219 Council Directive amending Directive 2006/112/EC.

220 European Commission (2018), *Impact Assessment*.

221 European Commission analyses in relation to Council Directive 2006/112/EC.

rised as turnover ones[222]. Any taxes, duties or charges being possibly understood as "turnover taxes" are to be adjudged not compatible with VAT. Court of Justice of the European Union (CJEU) set out the guidelines for interpretation of how to understand "turnover tax" as well as situations of shortfall in compliance[223]. To be classified as a turnover tax, it needs to display minimum one of the essential characteristics of VAT, namely:

- apply generally to transactions relating to goods or services,
- be proportional to the price charged by the taxable person in return for the goods and services supplied,
- be charged at each stage of the production and distribution process, including that of retail sale, irrespective of the number of transactions which have previously taken place,
- the amounts paid during the preceding stages of the process shall be deducted from the tax payable by a taxable person, with the result that the tax applies, at any given stage, only to the value-added at that stage and the final burden of the tax rests ultimately on the consumer[224].

Arguments provided by the European legislators were as follows. Infringement of characteristics 1, 3 and 4 cannot be found for tax would not apply generally to services and goods[225]. Consequently, any deduction of the taxable amount of money paid in earlier stages is not doable.

About the second characteristic, EC says it cannot determine to what extent the burden of tax shall be passed on to the consumer. In such circumstances of lacking certainty, current CJEU case law instructs that tax cannot be recognised as not-proportional and cannot be perceived as fulfilling given characteristics of VAT[226]. In consequence, the tax wouldn't classify as a "turnover tax" in the meaning of the VAT Directive, article 401[227].

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222 Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

223 CJEU, judgment of 3 October 2003, Banca popolare di Cremona, C-475/03, EU:C:2006:629, paragraph 28; CJEU, judgment of 11 October 2007, Kogaz and others, C-283/06, EU:C:2007:598, paragraph 37. See also CJEU, judgment of 8 June 1999, Pelzl and others, C-338/97, EU: C:1999:285, paragraph 21; and CJEU, judgment of 31 March 1992, Dansk Denkavit, C-200/90, EU:C:1992:152, paragraph 11.

224 *Ibid*.

225 European commission based on CJEU, judgment of 19 March 1991, Giant v Overijse, C-109/90, EU:C:1991:126, paragraph 14.

226 CJEU, judgment Pelz and others, paragraph 25; Giant v Overijse, paragraph 14.

227 European Commission (2018), *Impact Assessment*, pp. 148–149.

5.4. Common Consolidated Corporate Tax Base and the European digital tax – interaction

In 2016 the Commission issued a package of two bills, including:

- Proposal for a Council Directive on a Common Corporate Tax Base (CCTB)[228],
- Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)[229].

The importance of these regulations for digital tax is crucial. Some of the proposed digital tax structures described in this chapter refer directly to the regulations of CCCTB by introducing relevant provisions originating from it to capture the digital activity of enterprises. CCCTB could be considered a possible solution to certain problems in that field, once it takes into account elements such as digital permanent establishment and implications thereof.

Another angle is the necessity of coexistence between the CCCTB and digital tax proposals. To this end, the provisions of both projects, still in the planning phase, must enable consistency and cohesion. The European Commission stated that to make the current proposal for a Common Consolidated Corporate Tax Base (CCCTB) consistent with new digital tax rules, the CCCTB would have to be accordingly adapted thereto[230].

Common Consolidated Corporate Tax Base (CCCTB) is a project of legal provisions concerning the calculation of companies' taxable profits in the European Union. The directive shall establish uniform rules on the calculation of the corporate tax base in the EU internal market. The goal is, among others, reducing administrative costs, increasing legal certainty, encouraging investment and replacing debt by equity to finance the growth[231].

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[228] Common corporate tax base – as presented in European Commission (2016), Proposal for a Council Directive on a Common Corporate Tax Base, Strasbourg.

[229] Common consolidated corporate tax base – as presented in European Commission (2016), Proposal for a Council Directive on a Common Consolidated Corporate Tax Base, Strasbourg.

[230] European Commission (2018), *Impact Assessment*, 7ff.

[231] According to: European Commission Common Consolidated Corporate Tax Base (CCCTB) with the list of legislation and documents included therein.

The legislator pointed to the conveniences that this solution brings to enterprises implementing it:

- businesses can file a single tax return for all EU activities,
- possibility to offset losses in one Member State against profits in another one,
- companies are provided with incentives to invest in research and development, which enables them high tax deductions[232].

To sketch a historical outline its worth mentioning that the CCCTB project was proposed for the first time in 2011[233]. Back then, the proposal did not receive the necessary support of the Council. In 2016 the Commission decided to relaunch the initiative. In comparison to the 2011 proposal, the current one anticipates a few changes since it only involves the biggest companies. Additional elements were also added, aiming at research and development support.

Finally, the big step is made towards the cessation of incentives for debt accumulation. It implements "Allowance for Growth and Investment" ensuring that the company can collect equal benefits for equity and debt financing[234].

The current proposal that has not been rejected nor accepted altogether yet, consists of two steps. First is the implementation of the common European base. It brings a singular, European set of rules on how to tax the company's profit. For instance, it provides elements as the same capabilities of tax-deduction of certain expense around the EU or the same rate of depreciation for a particular asset in each Member State[235].

The second step is consolidation. It means the possibility of summing up the profits and losses of companies composing a group in different Member States. In consequence, the group would reach one net profit or loss for the whole EU. The ultimate amount of the group's taxable profits would be defined according to the common base provisions. It is important to indicate that every state preserves the final right to set out the rate of taxation towards profits assigned to it. After the establishment of a tax base

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232 *Ibid.*

233 European Commission (2011) Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), Brussels.

234 According to: European Commission Common Consolidated Corporate Tax Base (CCCTB) with the list of legislation and documents included therein.

235 According to European Commission (2016), Proposal for a Council Directive on a Common Corporate Tax Base.

for the company, these taxable profits are assigned to the Member States according to the so-called "apportionment formula[236]". The proportion of taxes by Member State is weighted out of three factors: the company's assets, the labour and the sales that the company made in a Member State[237].

According to the provisions in question, the CCCTB system would be mandatory in respect to large groups, with a global turnover exceeding EUR 750 million in the financial year. Smaller companies, with a global turnover below the threshold, can opt for it voluntarily[238].

Apart from CCCTB, the proposal aims to improve mechanisms to resolve double taxation disputes and certain tax loopholes. Finally, it is a very powerful tool in the battle against tax avoidance. For example, in respect to disputes mechanism improvement, it offers:

- extending the scope of cases covered by the dispute resolution mechanism,
- a new set of deadlines for resolving double taxation disputes addressed to the Member States,
- renewed mechanisms preventing blockage or prolongation of dispute resolutions[239].

Despite the enormous importance attached to the CCCTB project and the positive contribution of this initiative to the process of tax rules unification in Europe, the EC indicates the inevitability of further adjustments. The comprehensive tax system can be created on a European scale only in conjunction with separate regulations on matters arising from the digital

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[236] Formula will comprise three equally weighted factors (i.e. labour, assets and sales by destination). This combination reflects a balanced approach to distributing taxable profits amongst eligible Member States. The labour factor will be divided into payroll and the number of employees (i.e. each item counting for half) in order to account for differences in the levels of wages across the Union and thereby allow for a fairer distribution. The asset factor will consist of all fixed tangible assets. Intangibles and financial assets will be excluded from the formula due to their mobile nature and the risks of circumventing the system. These factors and weightings should ensure that profits are taxed where they are actually earned. By exception, where the outcome of the apportionment does not fairly represent the extent of business activity, a safeguard clause will provide for an alternative method of income allocation – according to European Commission (2016) Proposal for a Council Directive on a Common Consolidated Corporate Tax Base, 10.

[237] According To European Commission (2016), Proposal for a Council Directive on a Common Consolidated Corporate Tax Base.

[238] *Ibid.*

[239] European Commission (2016), Commission Staff Working Document Impact Assessment Accompanying the document Proposals for a Council Directive on a Common Corporate Tax Base and a Common Consolidated Corporate Tax Base (CCCTB) {COM(2016) 683 final} {SWD(2016) 342 final}, Strasbourg.

economy. Implementing regulations in both fields would allow European tax solutions to be adapted to the economic realities of the 21st century[240].

Highlighting this fact, EC pointed to "digital" issues that the CCCTB alone would not solve. Firstly, this regulation does not introduce novelties when it comes to capturing the non-physical presence of enterprises conducting digital activities in EU countries. The proposals are primarily based on existing principles, combining taxable presence with PE principle based on the physical presence of the company. The second aspect is the matter of sales by destination principle, which does not take into account the activity of some business models, primarily based on intangible assets and indirect sources of income. A standard example is an income from advertising activity, which is often the "additional" type of activity of the online platforms, parallelly being their main source of income. In such a situation, the apportionment, i.e. the formula introduced by CCCTB could not possibly capture the actual value creation activity[241]. A similar problem arises with tax avoidance actions through an artificial avoidance of the permanent establishment (PE) in a given country, since the CCCTB includes the same understanding of the PE as is present in international tax treaties[242].

6.
EUROPEAN DIGITAL TAX PROPOSALS – CRITICS

As presented above, the numerous project introduced by the European Commission was supported and highly regarded by scientists and scholars, some of them participated in the process of establishing it and consulting certain solutions. Nevertheless, part of the academics and experts expressed negative evaluation of the concept in question. Hereunder the reader may find the exemplification of criticism towards the European project as well as the description of the consequences thereof, referred to by the critics through the multidimensional approach reaching beyond the tax system.

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[240] European Commission (2018), *Impact Assessment*.
[241] *Ibid.*
[242] More about it in European Commission (2018), *Impact Assessment*.

The presence of voices calling for the need to reform the international tax system at the global level has already been emphasised many times in this thesis. It is worth noting, however, that it is at global level that the most widely understood interests of individual countries, regions and their representatives clash with each other. International taxation, being treated as the subject of international debates, becomes one of many economic and political elements strongly interconnected with others. This applies to, inter alia, international trade regulations of the WTO. In this way, the eventual international compromise becomes the sum of the components made up not only of the tax agreements and tax regulations but also other concessions and settlements, sometimes unrelated to the problem of taxation itself[243].

For the reason of the far-reaching economic consequences of introducing the digital tax, the European Commission's proposal found itself in the fire of criticism from some representatives of the scientific world.

In the article "The Cost of Fiscal Unilateralism: Potential Retaliation Against the EU Digital Services Tax" the negative effect the proposal could have on Europe, especially referring to the international principles of commercial law was presented[244].

Followingly the arbitrariness of indicating the digital economy as a field in which intangibles assets and user-generated value play a particularly significant role was emphasised. The author indicates that the presence of intangible elements is crucial for many areas of the economy, often appearing in connection with such elements as high branding expenditure and high R&D cost. Also, he states that data constitute a much higher share of intangibles among companies from plenty of other branches, such as pharmaceuticals, media, apparel, telecom, commercial services and others[245].

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243 An interesting reference to this phenomenon can be the following one. European digital taxation on certain "services" leads, as a consequence, to non-European taxation of European goods and services unrelated to digital activities (e.g. wine and cheese in the case of repercussions imposed by the US on France – more on this topic in the next chapter). Another example is the undermining of European provisions on digital tax on the ground of i.e. international commercial regulations and standards. These examples are to present the multidimensional and complex character of this subject.

244 Lee-Makiyama, H. (2018), *The Cost of Fiscal Unilateralism: Potential Retaliation Against the EU Digital Services Tax (DST)*, Brussels.

245 *Ibid*, p. 6.

The special role of users in the value creation process as an exclusive feature of the digital economy was criticised. As in the previous point, the author sought to show that other sectors of the economy are also highly susceptible and dependent on user contributions, often on data provided by users. The example of the financial sector was summoned. Then, the reference was made to advertising and its role in the process of creating profit. It was pointed out that targeted commercials mechanisms taking into account the reception of specific social groups are, even in a digitalised world, the domain of primarily traditional media[246]. After all, applying these criteria to an arbitrarily selected area of the economy can be reflected in similar steps taken by the countries whose companies are the most affected. However, these countermeasures may turn out to be much more serious than their European prototype, as a much wider range of economy branches can be targeted.

It was indicated that the threshold was established in such a way that its application was clearly referred to enterprises from two specific countries – the US and China. The main features determining the arbitrariness of the solution were identified to be: impossibility to classify digital services as trading, and thus exporting, as well as to calculate tax on revenues and restrictions related to its deduction and write-off possibilities[247].

The author accentuated that the European tax meets the criteria to be classified as an indirect tax on service imports as well as a customs duty. The EU is thus exposing itself to the reactions of countries such as the US or China that will impose similar burdens significantly exceeding the potential profits from the European digital tax[248].

Importantly, a quarter of EU exports of services go to the US market[249]. The European Union is the world's largest exporter in the field of cross-border services[250]. It means that retaliation by overseas countries may

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246 Based on eMarketer, Ad Spending in the EU-5: eMarketer's Estimates for 2016–2021, 2017 evoked in Lee-Makiyama, H. (2018), *The Cost of Fiscal Unilateralism…*, p. 6.

247 *Ibid*, p. 7.

248 The author presents the calculation stating that "reciprocal treatment by the US and China against the EU based on the same selection principles against EU services exports and subsidiaries could subject up to EUR 1,018.4 billion in gross turnover to taxation. A turnover tax of 3% could amount to EUR 31 billion – by far exceeding the EUR 4.7 billion the European Commission claims to collect from the DST".

249 Lee-Makiyama, H. (2018), *The Cost of Fiscal Unilateralism…*, p. 9.

250 Based on data from "Commission, Eurostat, 2017".

hit the EU economy much more than the digital tax will contribute to its development.

Along with the line presented above is also the article "Digital Companies and Their Fair Share of Taxes: Myths and Misconceptions". It indicated that the European Commission did not provide a sufficient explanation regarding the calculations on which the under-taxation of digital businesses was presumed [251].

It was stressed that the hypothesis about inequality in tax burdens between digital and non-digital enterprises as well as its scale is based primarily on estimates rather than on hard data. According to the author, the selective focus on digital companies being big on "stock markets" mixes up market capitalisation with corporate income. A focus on the world's "top 100 companies by market capitalisation" and the world's "top 5 e-commerce companies" hardly reflects the reality of the digital economy and profit levels among different firms[252]. The tax structure based on such presumed assessment of reality combined with the great degree of uncertainty cannot constitute a positive contribution to the European tax system and the Digital Single Market in Europe.

At the same time, the ambiguity of the limits of digital and non-digital economy makes it impossible to separate them with a thick line stating the precise and doubtless frontier between those domains. Besides, this demarcation remains contradictory to the thesis developed at the OECD about the need for avoidance of ring-fencing the digital economy. Digitalisation was called by the author a characteristic of all industries nowadays rather than a particular label allowing to separate a chosen group of businesses. For that reason, many European bodies did not express a positive attitude towards the Commission's proposal in a given form[253].

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[251] Bauer, M. (2018), Digital Companies and Their Fair Share of Taxes: Myths and Misconceptions, Brussels.

[252] *Ibid*, p. 6.

[253] *Ibid,* p. 3.

Chapter 3

Digital tax in European countries – legal projects and regulations

1. INTRODUCTION

Many countries involved in the processes taking place at the EU and OECD level expressed the will to take action and change the existing legal regulations and tax standards regarding the digital economy. In recent years, national legislators have taken steps that may be qualified as shaping both the principles of taxation of companies recognised as digital and taxation of singular digital activities in a new way.

Due to the enormous importance of the proposal of the European directives presented by the European Commission in March 2018, the classification of actions taken at the national level considers two categories: the ones developed before and after the European proposal.

Before the issuance of the European project, regulations have been characterised by a great variety, both in technical and substantive terms. Regulatory methods included both direct and indirect taxation. The subject of taxation has also gradually evolved in subsequent years, becoming much more comprehensive.

The table below presents the European and worldwide regulations adopted before March 2018 that had an impact on the legal framework of the digital economy for various reasons. These regulations were also the European Commission's reference point in the justification of the legislative proposal.

Table 8. Selected European and worldwide regulations, undertaken before March 2018, concerning taxation and relating to the functioning of the digital economy

Country	Planned/ adopted/ implemented	Type of tax	Brief description of the measure
EUROPEAN UNION			
United Kingdom	Implemented in 2015	Diverted profits	The diverted profits tax does not explicitly target "digital companies"– it targets contrived arrangements that erode the UK tax base through abuse of permanent establishment and transfer pricing rules. The diverted profits tax applies to UK and foreign companies using contrived arrangements designed to erode the UK tax base in the following two situations: if a foreign company artificially avoids having a permanent establishment in the UK; if a UK company, or a foreign company with a UK permanent establishment, use arrangements or entities which lack economic substance to exploit tax mismatches either through expenditure or the diversion of income within the group
Italy	In force since 2018	Administrative procedure for large non-resident multinational enterprises	This administrative procedure introduces an option for foreign companies that meet certain thresholds to discuss (and agree) in advance with the Italian tax authority the existence of a permanent establishment there. The terms apply to digital companies not headquartered in Italy having: at least EUR 1 billion in global revenue; and sales in Italy of at least EUR 50 million.
Slovakia	In force since 2018	Tax on income derived from intermediation through websites and online platforms	The tax will be levied at a rate of 21% on the income of "digital platforms", non-resident in Slovakia, despite the absence of a fixed place of business in this country. The proposed legislation defines digital platforms very broadly as "hardware or software platforms required for the creation of applications and their management".
THIRD COUNTRIES			
Country	**Planned/ adopted/ implemented**	**Type of tax**	**Brief description of the measure**
Israel	Implemented in 2016	The significant economic presence test for non-resident enterprises	Under well-defined circumstances income of foreign corporations from the sale of goods or provision of services via the Internet may be attributed to a "deemed permanent establishment" in Israel if: the foreign company maintains an operation in Israel; the foreign company sells directly products or services to clients in Israel or connects with customers in Israel through a local website

			(for instance, by way of a website operated in Hebrew language for Israeli market purposes); representatives in Israel of the foreign company are involved in identifying Israeli customers and/or gathering information; or the foreign company has provided authority to an Israeli representative to engage in transactions locally which are binding on the foreign company.
Australia	Implemented (2017)	Diverted profits tax and additional anti-avoidance rule for large non-resident multinational enterprises	The diverted profit tax aims to ensure that the tax paid by significant global entities properly reflects the economic substance of their activities in Australia and aims to prevent the diversion of profits offshore through contrived arrangements. Australia's diverted profit tax applies to multinational enterprises, which are qualified as "significant global entities", i.e. with annual global income of at least AUD 1 billion, that enter into a scheme which: has at least one of the parties connected to the scheme being a foreign entity; and results in a "diverted profit tax benefit", as defined in the law. There is also a de minimis threshold of AUD 25 million (for the local income) aimed at ensuring that the diverted profit tax only applies to companies that have sufficiently large operations in Australia.
United States	In force (2018)	The introduction of the concept of "base erosion anti-abuse tax" for large multinational enterprises	The new provision refers to base erosion as tax reduction strategies employed by multinational corporations that exploit differences between the tax laws of different countries in order to minimise or eliminate the amount of corporate tax paid. With respect to base erosion payments paid or accrued in tax years that begin after 31 December 2017, "applicable taxpayers" are now required to pay a tax, the "base erosion anti-abuse tax" (BEAT), equal to the "base erosion minimum tax amount" for the tax year. Applicable taxpayers are corporations (except for certain type of corporations) with average annual gross receipts of at least USD 500 million and a "base erosion percentage" of at least 3% (2% for certain banks and securities dealers). This percentage is equal to the aggregate amount of base erosion tax benefits of the taxpayer for the tax year divided by the aggregate amount of specified deductions allowable to the taxpayer for the tax year. A base erosion payment, in turn, generally means any amount paid or accrued by a taxpayer to a foreign person that is a related party of the taxpayer; and with respect to which a deduction is allowable, including any amount paid or accrued by the taxpayer to the related party in connection with the acquisition by the taxpayer from the related party of property of a character subject to the allowance of depreciation (or amortisation instead of depreciation).

INDIRECT TAXES (EXCLUDING VAT)			
Country	**Planned/ adopted/ implemented**	**Type of tax**	**Brief description of the measure**
Hungary	Implemented (2014), amended (2015, 2017)	Tax on advertisement	This tax is levied on any advertising activity, whether it is in printed or digital form. The tax is income based: a yearly income from advertising activity over HUF 100mn (approximately EUR 322,000) is taxed at the rate of 5.3%. An entity can be the subject of the advertising tax if it: publishes advertising for others, providing advertising services and realising income from such activities; publishes an advertising to promote its own services or products or (irrespective of where it is domiciled) orders advertising from a media content provider settled in Hungary.
France	Implemented (2003), amended (2016)	Levy on access to content, including digital content by means of a video on demand / over-the-top online platform (for the cinematography fund)	The levy covers activities of making available services giving access (against consideration) to cinematographic or audiovisual works, on individual request formulated by an electronic communication method. Services whose audiovisual content is secondary, services whose main purpose is devoted to information and services that mainly provide information related to Cinematographic and audiovisual works and to their dissemination and promotion, are exempt. The taxable amount is the amount paid by advertisers and sponsors, for the dissemination of their advertising services to the relevant taxpayers or the directors of advertising messages, excluding value-added tax. These sums are reduced by 4%. The reduction goes up to 66% in the case of services giving or allowing access to audiovisual content created by private users for sharing and exchanging within communities of interest.
Germany	Implemented (2004), amended (2010)	Levy on access to content, including digital content by means of a video on demand / over-the-top online platform (for the cinematography fund)	The film levy in Germany (Filmabgabe) helps financing the German Federal Film Board. The rate of the film levy is between 1.8% and 2.5% of the annual net sales. Video-on-demand providers that collect less than EUR 500,000 a year through cinematographic works are exempt from the levy Private broadcasters with free-to-air programmes pay a film royalty on net advertising revenue. The film levy varies between 0.15% and 0.95% and depends on the share of cinematographic films in the total broadcasting time. Private broadcasters whose total net revenue is less than EUR 750,000 for such services are exempt. Organisers of pay-tv and programme marketers pay a fixed film levy amounting to 0.25% of their net sales in Germany, either with subscription contracts or for individual consideration. Suppliers who show no or only a few films (less than two percent of the total time) or whose total net sales with these offers is less than EUR 750,000 are exempt from the film levy.

Romania	Implemented (2005), amended (2008)	As above	The mandatory contribution to the cinematography fund is levied at 3% on the turnover from audio and video content legally downloaded in digital format and at 1% on the turnover from the digital re-transmission of TV shows
Croatia	Implemented (2007)	Levy on access to content	Levy on access to content, including digital content by means of a video-on--demand online platform (for the cinematography fund). The levy amounts to 2% of the taxable turnover.
Portugal	Implemented (2007)	As above	The levy amounts to 1% of the taxable turnover. There is an option between contribution to the cinematography fund or investment in production.
Belgium (certain regions)	Implemented (2009)	As above	In Wallonia and Brussels, contributors can opt either to transfer, respectively, 1.4% and 2.2% of the taxable turnover to the film fund or to make an equivalent investment directly in films.
Czech Republic	Implemented (2012)	As above	The levy amounts to 0.5% of the respective turnover.
THIRD COUNTRIES			
Country	**Planned/ adopted/ implemented**	**Type of tax**	**Brief description of the measure**
United States (certain states), Canada (certain states)	Implemented in US in 2016, Planned in Canada and Brazil in 2018	Levy on access to digital content and streaming services	
India	Implemented (2016)	Levy on the provision of online advertisement services by non -residents	The Indian "equalisation levy" is imposed on e-commerce transactions whereby a resident or a non-resident with a permanent establishment carrying on a business or profession in India is obliged to withhold 6% equalisation levy from payments made to a non-resident service provider for specified services. These services include online advertisements, provision of digital advertising space, or any other facility or service for the purpose of online advertisements or any other notified services, except where the aggregate consideration for the specified service is less than INR 100,000 (EUR 1,300). The levy does not apply if the service provider is a non-resident who has a permanent establishment in India to which the service is effectively connected and such income is attributable.

Source: COMMISSION STAFF WORKING DOCUMENT IMPACT ASSESSMENT Accompanying the document Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence and Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services {COM(2018) 147 final} – {COM(2018) 148 final} – {SWD(2018) 82 final}, Brussels, pp. 124–129.

In face of the legislative failure at the European level in 2018, some countries decided to introduce appropriate tax regulations on their own. From the material and technical side, one can notice a great convergence of national projects with the original European initiative. The scope of regulations varies from one country to another, but all of them implement postulates clarified by the UE, referring to the need for taxing digital activities that are currently outside the tax framework.

The following are some examples of the latest regulations in selected European countries. At this point, the author wishes to emphasise the importance that should be attached to a closer reading of the following, largely technical regulations. Although some of them are only at the stage of lawmaking, the patterns they contain are the subject of debates and similar legislative ideas in other countries. States wishing to initiate legislative procedures in this area carefully analyse the drafts of the European directives, as well as the solutions implemented by other pioneer Member States.

2. DIGITAL TAX SOLUTIONS IN SELECTED EUROPEAN COUNTRIES

2.1. France

On 24 July 2019, the President of the French Republic promulgated the law n° 2019-759 creating a tax on digital services and modification of the trajectory of the decline of the tax on companies[254]. This way, France became one of the very first countries (first in Europe) adopting legal regulations on digital companies in the scope of their "digital presence" on the French territory.

At this point, it is worth mentioning the social and political context of this bill. The press release issued by the Senate says that the tax is inspired

[254] LOI n°2019-759 du 24 juillet 2019 (JORF n°0171 du 25 juillet 2019) portant création d'une taxe sur les services numériques et modification de la trajectoire de baisse de l'impôt sur les sociétés.

by the European Commission's proposal for a directive on the common system of digital services tax. According to the government, this tax meets an immediate imperative of tax fairness and will apply as long as the rules of international taxation have not been adapted to recognise the digital presence of digital companies for taxation of their profits. The output predicted by the Government is expected to reach 500 million euros per year[255].

The French Government initiated the accelerated procedure on the bill on 6 March 2019. On 9 April 2019, the National Assembly adopted the bill on first reading. Subsequently, the bill passed in the Senate on 21 May. The next step, according to the French legislative procedure[256], was an agreement between the mixed joint commission reached on 11 July[257]. On 24 July the President of the Republic promulgated the bill[258].

The act providing changes in the French tax law regulated two issues. Article 1 created a new tax on digital services. Alongside this regulation, the Parliament voted on Article 2 touching upon different areas of the tax law, relating to the modification of the downward trajectory of corporation tax. The coexistence of these matters found reflection in the title of the bill in question[259]. The Senate Commission, while referring to the project of Article 2 said that the immediate objective of the bill is to generate additional revenue in response to the "yellow vests" crisis, which would cost EUR 10.8 billion in 2019. Thus, the correlation between two regulations, can be found on social grounds evoked by the legislator. The common element between them both is the need to "level out social inequalities" by tax burden on the so-called "largest" companies[260].

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255 Sénat, Espace presse: Création d'une taxe sur les services numériques, http://www.senat.fr/espace_presse/actualites/201904/creation_dune_taxe_sur_les_services_numeriques.html [accessed 22.01.2020].

256 So called la navette procedure.

257 Full name of the commission: la commission mixte paritaire chargée de proposer un texte sur les dispositions restant en discussion du projet de loi portant création d'une taxe sur les services numériques et modification de la trajectoire de baisse de l'impôt sur les sociétés.

258 Based on: Sénat, Espace presse "Création d'une taxe sur les services numériques, section "Les étapes de la discussion".

259 Loi n° 2019-759 du 24 juillet 2019 portant création d'une taxe sur les services numériques et modification de la trajectoire de baisse de l'impôt sur les sociétés.

260 According to "Commission des finances, Rapport n° 496 (2018-2019) de M. Albéric de Montgolfier, rapporteur général de la commission des finances, sénateur d'Eure-et-Loir".

Article 1 of the bill amends the provisions of the French tax code[261]. It introduces a tax on the revenues derived from certain services provided by large companies in the digital sector. Taxation relates to companies deriving a significant part of their revenues from the participation of Internet users located on the national territory of France.

Article 3 provides for the submission of a governmental report to the Parliament on the outcomes of taxation as well as the economic impact thereof[262].

The tax aims to apprehend the value generated by the users located in France. Two types of digital services are taken into account:

– The intermediation services that allow users to contact and interact with each other, especially for the delivery of goods or the provision of services directly between users.
– Targeted advertising, namely, the services of placing targeted ads based on user data, as well as the sale of data for advertising purposes, namely all sales of data for the targeted advertising[263].

The scope excludes certain domains: communication services, payment services, regulated financial services, online commerce, and provision of digital services.

The user of a digital interface is deemed to be present in French territory when he consults the interface through the terminal placed in France.

A tax rate is established at the level of 3% of revenues from taxable activities. It is applied to a specific base, corresponding to the product of the total amount of taxable services received by the company in the world and the proportion of their French users. There are two revenues thresholds for taxable services:

– 750 million euros worldwide,
– 25 million euros attached to France.

If enterprises are related, directly or indirectly, the threshold mentioned above corresponds to the revenues of the group. Taxable services provided between companies belonging to the same group are excluded from the scope of taxation. The tax liability burdens the entity who cashes the sums. Moreover, the tax becomes chargeable at the moment when the generating event occurs[264].

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261 Based on „Code général des impôts, Version consolidée au 1 mars 2020“.
262 Loi n° 2019-759 du 24 juillet 2019.
263 *Ibid*, Article 1.
264 *Ibid*.

The bill also provides the way of calculation of the tax obligations. When a taxable service is provided in France during a calendar year, two steps of calculation are in place. Firstly, the amount of the receipts paid in return for supplying digital service shall be the product of all worldwide receipts paid during that year in return for this service. The amount of all receipts is subsequently divided by the representative percentage of the share of these services related to France during the same year.

The legislator also indicated the rules for collecting advance payments for tax. According to the procedure, the taxable person may be requested to justify all the elements used to calculate the tax by the proper authority. The request shall indicate the points to which it relates, as well as set a deadline for response, which cannot be less than two months. In case of an insufficient answer, tax authorities shall send a formal notice giving 30 more days, after which they proceed with the taxation process ex officio.

Three modes of tax payment were established. The first two indicate the mode applicable to VAT, subject accordingly to the normal VAT tax system and the simplified VAT tax system. In other cases, the annual declaration must be presented to the competent tax authority by 25 April of the year following the one in which the tax obligation occurred. Whatmore, a procedure has been established for tax authorities, allowing them to examine the compliance of data provided by the taxpayer[265].

The temporal character of the regulation can be seen in governmental obligation to submit an annual report on the negotiations conducted within the OECD[266]. The report shall be submitted by 30 September of each year. Additionally, the government is obliged to provide the Parliament with the report concerning the state of taxation in the commerce sector, especially the levy difference between the "physical" trading companies and the online trading companies. This report was to be submitted within three months of the promulgation of this act. The government was also obliged to inform the Parliament on reasons for the lack of notification that should be submitted to the European Commission, according to Article 108 (3) of the Treaty on the Functioning of the European Union[267].

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265 *Ibid.*

266 *Ibid.*

267 This article refers to the obligation of Member States. According to Article 108(3) of the Treaty on the Functioning of the European Union "The Commission shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid". The issue of possible non-compliance arising from the national regulations of digital tax with European measure on public aid is submitted to discussion in the further part of this thesis.

Lastly, the bill presents governmental obligation to report annually on certain characteristics concerning the implementation of this new tax. Especially, concerning the distribution of the product of the tax in the function of the categories of services as well as the geographical origin of the groups liable to pay[268].

During the legislative process, the Finance Committee of the French Senate issued a report profoundly analysing and explaining the legislation[269]. According to the report, the creation of a tax on digital services pursues the imperative of tax fairness, seeking fairer taxation of digital businesses. The inadequacy of the current rules on the distribution of rights to impose taxes can benefit the "digital giants". Also, an indication was made, stating that a study by the European Commission published last year estimated the tax differential between digital multinationals and traditional multinationals at 14 points. Subsequently, the report underlined that the work over OECD's BEPS had not fully succeded[270]. The report stated that about thirty companies shall be subject to this tax, with an estimated yield of 400 million euros in 2019[271].

The consecutive section of the report provided a very insightful analysis of legal risks under European Union law and tax treaties. The first risk concerns European regulations of state aid, given digital tax applies to only certain companies. Although not necessarily contrary to the Treaty on the Functioning of the European Union, the digital service tax should at least be notified to the European Commission, on pain of being tainted by wrongdoing on a simple question of procedure. The government's choice not to make this notification constitutes a major risk for the future since the questioning of the tax can lead to the reimbursement of amounts unduly received[272].

The second risk under European legal regulations concerns the freedoms of movement. Given its characteristics, the tax targets almost only non-resident groups. The fact that 80% of the tax return comes from foreign groups can be seen as disguised restrictions[273].

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268 *Ibid*, Article 5.

269 Rapport n° 496 (2018–2019) de M. Albéric de Montgolfier, fait au nom de la commission des finances, déposé le 15 mai 2019 sur la Projet de loi portant création d'une taxe sur les services numériques et modification de la trajectoire de baisse de l'impôt sur les sociétés.

270 *Ibid*, section called "Des Réflexions Conduites pour Actualiser le Système Fiscal International n'excluent pas la Mise en Oeuvre de Solutions Nationales Spécifiques".

271 *Ibid*, section called "II. Examen du Rapport (15 MAI 2019))".

272 *Ibid*, section called "La taxe sur les services numériques sera complexe à mettre en oeuvre".

273 *Ibid*, section called "La taxe soulève plusieurs questions juridiques qui devront être tranchées".

The third risk and legal uncertainty is the possible requalification of the digital services tax as falling within the scope of tax treaties. The effects of the tax would then be annihilated[274].

Also, the report pointed at the practical issues of implementation:

- turning to turnover, the tax will directly impact the cash flow of companies that are not necessarily profitable,
- given their market position of the companies concerned, they could move the burden of the tax towards users,
- collecting the tax will be complex. It is based on a fully declarative procedure[275].

In case of the absence of a declaration submitted by taxed companies, the procedure of automatic taxation will be difficult to implement by the administration. Lastly, tax revenues remain very uncertain and will primarily be a function of the "fairness" of the companies that are subject to it[276].

In the end, the Senate finance committee also provided certain recommendations. The first one invokes the need to formally include the temporality of the regulation in the text. The amendments were also presented to limit the possible problem of double taxation effect. Although it does not assure a total neutralisation of double taxation, it can directly lighten the effect on the cash flow of companies in question.

Finally, the tax is hinged upon the ability to detect users located in France. Such an activity must be reconciled with data protection. To determine the location criterion following data protection regulations, the committee proposed to refer to a decree of Conseil d'État[277].

The French tax met with a strong political response from US representatives. In July 2019 the United States Trade Representative launched an investigation to examine if the French tax has classified as an unfair trade practice, discriminating against American companies.

At the end of August 2019, a compromise on a French tax was reached between France and the United States. According to the agreement, France committed to pay back differences between its digital tax and any

274 *Ibid*, section called "Les risques de «victimes collatérales» de la taxe sont reels" ff.
275 Rapport n° 496 (2018–2019).
276 *Ibid*.
277 *Ibid*, p. 4.

future taxes resulting from the mechanism developed by the Organisation for Economic Cooperation and Development (OECD). President Emmanuel Macron confirmed reaching an agreement with the US during the G7 summit in Biarritz. He also underlined that the French solution would be withdrawn, once the international agreement is in place[278].

Additionally, Americans claimed to enforce duties of up to 100% on imports of targeted French products, such as champagne, handbags, etc[279]. Given the circumstances, the French government decided at the beginning of 2020 to delay collecting a new tax until the end of 2020[280].

Having in mind the very early stage at which any national regulations concerning digital activities are Europewide and worldwide, the characteristic of problems can be highly similar for other countries and projects addressing this subject. Potential problems of incompatibility with European law need to be faced during the examination of any project within the EU. Some of them, i.e. the ones referring to the regulation of state aid, can be a technical signpost for legislators around Europe. Others, like the possible infringement of freedom of movement, need to be carefully regarded as an essential issue concerning the very construction of the tax and the scope of taxation.

2.2. Austria

Austria is another country that decided to introduce a national digital tax. On 19 September 2019, the lower house of the Austrian Parliament accepted the bill. Austria's Federal Council, the upper house of the Parliament, approved the regulation on 10 October[281].

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[278] Gold, H., US and France reach compromise on digital tax, *CNN Business*, https://edition.cnn.com/2019/08/26/business/digital-tax-france-us/index.html [accessed 26.08.2019].

[279] ar-Gupta, S., Van Overstraeten, B., France, US set two-week target for resolving digital tax spat, *Reuters,* https://www.reuters.com/article/us-france-usa-tax/france-us-set-two-week-target-for-resolving-digital-tax-spat-idUSKBN1Z60SM [accessed 7.01.2020].

[280] According to the French Government's representative declaration, issued and described by BBC "France agrees to delay new tax on tech giants", 14.04.2020.

[281] According to Austrian Parliament information, https://www.parlament.gv.at/PAKT/VHG/XXVI/ME/ME_00132/index.shtml [accessed 11.10.2019].

On 22 October, the new tax law officially appeared in the Austrian Federal Law Gazette[282] followed by the Ordinance of the Federal Minister of Finance issued on 9 December, 2019[283]. It applies from the beginning of 2020. The outskirts of the projects and provisions implemented therein are described below.

The definitions and concepts presented in the bill are based on the European Commission's proposal for a Directive on Digital Services Tax[284]. At the same time, a particular focus was given to one among the digital activities described at the European level, namely the revenues coming from the advertisement services. An online advertising service is understood as advertisements on a digital interface, in particular in the form of banner advertising, search engine advertising and comparable advertising services[285]. It is considered to be provided domestically when the user's device has a domestic IP address as well as when the content is targeted at domestic users[286]. Users can be a natural or legal person using a device with access to the digital interface[287]. The issue of whether the user actually watches or clicks on a particular content is of importance only if the fee is calculated accordingly[288].

The subject of taxation is online advertising services provided in Austria against payment. Companies are subjected to taxation when they provide or contribute to the online advertising services against payment and they pass the following thresholds:

- EUR 750 million of turnover worldwide from online advertising services,
- EUR 25 million of turnover in Austria from online advertising services[289].

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[282] Digitalsteuergesetz 2020 (DiStG 2020), Bundesgesetz, mit dem das Digitalsteuergesetz 2020 erlassen und das Umsatzsteuergesetz 1994 geändert wird (132/ME XXVI. GP).

[283] Verordnung des Bundesministers für Finanzen zur näheren Regelung der Umsetzung des Digitalsteuergesetzes 2020 (DiStG 2020-UmsetzungsV).

[284] European Commission (2018), Proposal for a Council Directive 2018/0072(CNS) and European Commission (2018) Proposal for a Council Directive 2018/0073(CNS).

[285] Digitalsteuergesetz 2020, Artikel 1.

[286] The location of the provision of online advertising services may be determined based on the IP address or with the help of other technologies for geolocation of devices – according to the tax clarification information from the Austrian Ministry of Finance, Digitalsteuergesetz 2020 .

[287] Which means any software that the user can access.

[288] According to the provisions of Digitalsteuergesetz.

[289] *Ibid*, Artikel 1.

The tax rate is set at 5%. Its base is constituted of revenues received from customers, reduced by spending on up-market services by other online advertisers. When the enterprise is a part of a group, digits above refer to that group[290].

The tax debtor is the online advertising agent who has rights to a fee against the performance of online advertising services. This also happens if the digital interface is not owned by the online advertiser.

The bill also contains provisions touching upon the tax collection procedure. The taxpayer would calculate the due amount and pay it by the 15th of the second month following the tax claim. The claim arises at the end of the month in which the taxable service is rendered.

The taxpayer is also obliged, in the period of three months after the end of the year, to submit the tax declaration providing for certain information, such as the types of advertisement services, the global turnover of the company, etc. For these purposes, among others, taxpayers are obliged to keep records of rendered advertising services, any commissions towards other companies in the scope of this activity, clients' information, detailed way of tax calculation, etc[291].

According to the project, 15 million euros collected from tax revenues shall be attributed to digitalisation fund supporting media companies enabling digital transformation. Particularly, the related expansion of digital services and their constant development to the constantly changing user behaviour should be promoted by these means[292]. The Ministery of Finance is obliged to regularly report, from 31 December 2021, on elements as uniformity of taxation, application of taxation as well as the enforcement and their impact on companies, also in the scope of further measures undertaken at the EU or OECD level. Authors of the bill also specify that it remains subject to evaluation and further adjustments in case a new reconciliation appears at the OECD or European level[293].

Regulations apply to online advertising services provided after 31 December 2019. The Bill constitutes a revision of the current act on the advertising of 2000[294]. The previous advertising levy covered only "clas-

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[290] *Ibid.*
[291] *Ibid.*
[292] *Ibid.*
[293] *Ibid.*
[294] Bundesgesetz, mit dem eine Abgabe auf Werbeleistungen eingeführt wird (Werbeabgabegesetz 2000) StF: BGBl. I Nr. 29/2000.

sic" advertising, for instance from print media, radio, television, and posters.

The documents accompanying the tax bill provide further information[295]. *Digitalsteuergesetz 2020* aims to increase tax fairness, introducing a simple, flat-rate tax. The idea, according to the authors, is inspired and based on the European proposal. Furthermore, the Federal Minister of Finance should be authorised to make appropriate adjustments, in the form of an ordinance, permitting to react flexibly to new global developments in the field of "digital economy"[296].

The temporal character of the tax is underlined, with the time limit depending on solutions elaboration processes on EU and OECD grounds[297].

Alongside the bill, the government also issued an impact assessment document[298]. It provides reasons for the new law. According to the document, digital economy companies often pay much lower taxes than competitors from the traditional segment. Comprehensive, global action is perceived as time-consuming. For several years, the OECD and the EU have been working on such solutions, so far without agreement. As in various other EU Member States, digital tax is intended to contribute to increasing tax fairness.

The impact assessment document forecasted the income of 25 million euros to be collected in 2020. Throughout the next years, it indicated a steady rise in incomes, about 3 milion every year, reaching 28 million in 2021, 31 million in 2022, 34 million in 2023[299].

The Austrian proposal limits the scope of taxation to the narrow group of activities based on online advertisement. This differentiates the bill from the one accepted in France a few months earlier. At the same time, we can find a big influence of the European DVT proposal, especially when it comes to tax construction, references to companies' turnover both globally and locally as well as legal definitions. As in the case of the tax

295 Austrian Ministry of Finance, Ministerialentwurf – Erläuterungen 132/ME XXVI. GP.
296 *Ibid*, p. 1–3.
297 According to the tax clarification information from the Austrian Ministry of Finance, Digitalsteuergesetz 2020.
298 Austrian Ministry of Finance, Ministerialentwurf – Vorblatt und Wirkungsorientierte Folgenabschätzung 132/ME XXVI. GP.
299 *Ibid*, p. 1.

in France, some doubts related to the legal compliance of certain provisions concerning i.e. unfair trade practices or possible data security issues can be raised.

2.3. Italy

In the last few years, Italy has been one of the European leaders pursuing the idea of digital tax at the national level. In 2017 a proposal on setting a 3% tax rate on revenues from digital services, so-called "WEB Tax" was presented[300]. The project, originating from the Chamber of Deputies, was withdrawn and did not enter into force[301].

Subsequently, the Italian Budget bill in 2019 included another proposal, providing the Italian Digital Services Tax (DST)[302]. According to Italian law, the project necessitated the issuance of an implementing decree in the period of the following four months. By 30 April the adoption of DST was not successful since the implementing decree was not introduced[303]. The concept itself was to be taken into consideration again, in the 2020 Budget bill.

Successively, the decree approved on 15 October 2019, opened the final path to implement the tax from 1 January 2020[304].

According to the bill, the base for taxation would be the revenues coming from digital supplies. Digital services, falling under the scope of taxation, are defined as the following actions:

a) transmission on a digital interface of targeted advertising to users of the same interface;

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300 The Web tax was included as a dedicated source of income in the 2018 Budget Bill – Nella G.U. n. 302 del 29 dicembre 2017, è stata pubblicata la Legge di Bilancio per il 2018 (Legge n. 205 del 27 dicembre 2017).

301 According to Fonte, G., Italy readies "web tax" in its 2020 budget: sources, *Reuters* 2019, https://www.reuters.com/article/us-internet-tax-italy/italy-readies-web-tax-in-its-2020-budget-sources-idUSKBN1WT1VA [accessed 13.02.2020].

302 2019 Budget bill – Bilancio di previsione dello Stato per l'anno finanziario 2019 e bilancio pluriennale per il triennio 2019–2021. (18G00172) (GU Serie Generale n.302 del 31-12-2018 – Suppl. Ordinario n. 62).

303 According to Daniel Bunn "The Italian DST Remix", taxfoundation.org, https://taxfoundation.org/italy-digital-tax/ [accessed 13.02.2020].

304 According to Cinieri, S., Web tax: tassazione al 3% dal 2020 per chi opera nel mondo digitale, Wolters Kluwer 2019.

b) provision of a digital multilateral interface which allows users to be in touch and interact with each other, also to facilitate the direct supply of goods or services;
c) transmission of data collected from users and generated from the use of a digital interface[305].

Some activities were explicitly excluded from the scope of taxation, e.g. concerning financial services. The list of exclusions complies with the one accompanying the European project.

The bill set forth two thresholds:

– worldwide revenue of at least EUR 750 million for the relevant financial year,
– annual revenues of a minimum of EUR 5.5 million for the relevant financial year coming from digital services supplied in Italy[306].

The tax period coincides with the calendar year. A revenue is deemed taxable in a given tax period if the user of a taxable service is located in Italy during the said period[307]. As in the proposals from France and Austria, an IP address or other geolocator is used to determine if the device is located in Italy. A user is regarded as localised in Italy if:

– ads are displayed on the user's device due to his access to the digital interface when the device is used in the territory of Italy during the tax period,
– the user uses a device in the Italian territory to access the digital interface and concludes a corresponding operation on this interface,
– the user has an account which allows him to access the digital interface and this account has been opened using a device in the Italian territory,
– the data generated by the user who used a device in the Italian territory to access a digital interface during the tax period or a previous tax period, are transmitted[308].

If the enterprise is part of a group, thresholds apply to the revenues of the group.

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305 Based on The new Digital Service Tax has entered into force in Italy, Hogan Lovells Publications, https://www.hoganlovells.com/en/publications/the-new-digital-service-tax-has-entered-into-force-in-italy [accessed 16.02.2020].

306 *Italy's unilateral Digital Services Tax advances*, Erst&Young, Rome 2019.

307 *Italy's draft 2020 budget calls for unilateral digital services tax,* PricewaterhouseCoopers, Rome 2019.

308 *Ibid.*

Revenues from digital services to users located in the Italian territory are taxable:

- For supplies of targeted advertising, in the proportion of advertising placed on a digital interface as per the data related to a user accessing such interface while in Italy.
- For the making available of multisided digital interface, in the proportion of the delivery of goods or performance of services for which one of the users is located in Italy (or in the proportion of the users that have an account opened in Italy and that have used the interface during the year).
- For the sale of data, in the proportion of the users whose data were generated during the period while they were located in Italy[309].

Payment calculation would take place quarterly. The application of the tax is limited and does not apply in case of services provided within a group, in case that any entity is controlled by another or they are submitted to control of a common entity.

The tax shall be paid on an annual basis, by 16 February of the following year. Additionally, taxable subjects are obliged to present the annual declaration concerning taxable services. They also must keep monthly accounting records concerning taxable services, including elements important for tax calculation. In the case of the group, a single company shall fulfill the obligations referring to the group upon an appointment. A tax representative has to be indicated in certain cases of a non-resident without a Permanent Establishment in Italy[310].

It was also emphasised that if an international agreement on the taxation of the digital economy is concluded, the act will cease to apply[311]. The sum of revenues expected to be collected yearly was acknowledged as EUR 600 million in 2020 and 2021[312].

Keeping in mind the characteristics of the European proposal, the Italian one appears to be very close to the original.

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309 *Ibid.*

310 *Ibid.*

311 *Italy's 2019 budget law introduces a digital service tax*, PricewaterhouseCoopers, Roma 2019, https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-italy-2019-budget-law-introduces-a-digital-service-tax.pdf [accessed 15.02.2020].

312 Bunn, D., *The Italian DST Remix*, Tax Foundation, https://taxfoundation.org/italy-digital-tax/ [accessed 15.02.2020].

2.4. The United Kingdom

In November 2017[313] and 2018[314] the British government presented the challenges of the corporate tax system in the context of the evolving digital economy, including them in the public position papers. It comprised a request for international tax rules' urgent reform, and stated the need to ensure that value created by users for digital companies is reflected in tax regulations.

The UK's Digital Services Tax (DST) was originally foreshadowed on 29 October 2018. It was announced that in the absence of any new international agreement, the British Government would introduce a new tax [315]. In November 2018 the Government launched a consultation on the detailed design and implementation of the DST. The paper underlined the Government's aim that the DST would apply from April 2020 and be legislated in the Finance Bill 2019-20[316].

On 11 July the Government decided to introduce a Digital Services Tax proposal[317] (DST) along with Digital Services Tax Draft Guidance[318]. The final version of the bill entered into force on 1 April 2020[319].

While explaining the reasoning for the introduction, the HMRC[320] stated that the application of the current corporate tax rules to businesses operating in the digital economy has led to a misalignment between the place where profits are taxed and the place where value is created[321].

British digital services tax is charged on UK digital services revenues arising to a person in an accounting period. The "digital services revenues" of a group are understood as the total amount of revenues arising

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313 United Kingdom HM Treasury (2017), *Corporate tax and the digital economy: position paper,* November, London 2017.

314 *Ibid.*

315 Seely, A. (2020), *Digital Services Tax*, House of Common Briefing Paper (3 April), London, p. 14.

316 *Ibid*, p. 15.

317 *Introduction of the new Digital Services Tax – draft legislation* (2019), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/816361/Digital_services_tax.pdf [accessed 2.04.2020].

318 *Digital Services Tax Draft Guidance*, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/817666/20190711_-_Draft_Guidance_vfinal.pdf [accessed 2.04.2020].

319 According to: *United Kingdom Finance Bill 2019-21*, part 2 (clauses 38–71); version from 18 March 2020.

320 Her Majesty's Revenue and Customs.

321 Seely, A. (2020), *Digital Services Tax*… 30.

to members of the group in connection with any digital services activity of any member of the group[322].

The notion of "UK digital services revenues" means revenues attributable to UK users. The following categories of those revenues were identified:

1. Revenues classified as "online marketplace revenues" in cases where:
   a) they arise in connection with a marketplace transaction, and a UK user is a party to the transaction, or
   b) they arise in connection with particular accommodation or land in the United Kingdom, or
   c) they arise in connection with online advertising for particular services, goods or other property, and the advertising is paid for by a UK user.
2. Revenues classified as "online advertising revenues" in cases where:
   a) they are not within any of cases referred to in the point 1 above, and the advertising is viewed or otherwise consumed by UK users, or
   b) the revenues are not within any of cases described so far but they arise in connection with UK users[323].

Three types of digital services activity were established:

1. Social media service – an online service that meets the following conditions:
   a) the main purpose, or one of the main purposes, of the service is to promote interaction between users (including interaction between users and user-generated content), and
   b) making content generated by users available to other users is a significant feature of the service.
2. Internet search engine.
3. Online marketplace – means an online service that meets the following conditions:
   a) the main purpose, or one of the main purposes, of the service is to facilitate the sale by users of particular things, and
   b) the service enables users to sell particular things to other users, or to advertise or otherwise offer particular things for sale to other users[324].

[322] The United Kingdom Finance Bill 2019–21, part 2, clause 39.
[323] *Ibid*, clause 40.
[324] *Ibid*, clause 42.

Any reference to providing a social media service, Internet search engine or online marketplace includes carrying on an associated online advertising service[325].

According to the bill, "UK user" is any user who it is reasonable to assume that:

- in the case of an individual, is normally in the United Kingdom,
- in other cases is established in the United Kingdom[326].

The tax rate is 2%. Two thresholds were established, provided as the following conditions:

- the total amount of digital services revenues arising in that period to members of the group exceeds £500 million, and
- the total amount of UK digital services revenues arising in that period to members of the group exceeds £25 million[327].

The liability of a relevant person to digital services tax in respect of the accounting period is established according to the following calculation:

- Step 1 – Take the total amount of UK digital services revenues arising to members of the group in the accounting period.
- Step 2 – Deduct £25 million from the amount found under step 1.
- Step 3 – Calculate 2% of the amount calculated under step 2. The result is "the group amount".
- Step 4 – The relevant person's liability to digital services tax in respect of the accounting period is the appropriate proportion of the group amount[328].

Digital services tax is due and payable on the day following 9 months from the end of the accounting period[329]. The digits indicating a prediction of revenues from tax collection set the amount of about £2 billion for the five years period[330].

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[325] *Ibid*.
[326] *Ibid*, clause 43.
[327] *Ibid*, clause 45.
[328] *Ibid*, clause 46.
[329] *Ibid*, clause 50.
[330] *Ibid*, p. 32.

2.5. Spain

Spain was one of the first countries demonstrating a positive attitude towards the concept of taxing the digital activity of international companies. This fact was reflected, among others, in a joint statement made by the ministers of several EU countries and addressed to the European Commission in 2017[331].

The first public project of the DST (Digital Service tax) was published in October 2018[332]. Followingly, after reaching the agreement of the Council of Ministers as well as gaining some amendments, the official legislation proposal appeared on 25 January 2019[333]. On 18 February 2020, the Spanish Government approved the tax bill for the parliamentarian discussions[334].

The bill imposes a tax on the revenues deriving from certain digital activities. According to the draft, only digital services for which the role of Spanish users is crucial in the value creation process are subjected to taxation. The tax is defined as an indirect one, compatible with VAT. Given its characteristics, this classification appears to be simplified since it rather constitutes a certain hybrid between direct and indirect taxes[335].

The subject of taxation includes the following activities:

– Targeted adverts placement on a digital interface. The activity will be subject to taxation when the device on which the advertisement appears to the user is located in Spain. The tax base calculation will take into account the number of adverts impressions on Spanish devices and determine the proportion to the total number of impressions[336].

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331 Based on the Political Statement "Joint initiative on the taxation of companies operating in the digital economy" that supported EU law compatible and effective solutions "based on the concept of establishing a so-called equalisation tax on the turnover generated in Europe by the digital companies".

332 Documento Sometido a Trámite de Información Pública 23/10/2018 Anteproyecto de Ley XX/2018, de XX de XX, Del Impuesto Sobre Determinados Servicios Digitales, La Ministra de Hacienda, Madrid 2018.

333 121/000039 Proyecto de Ley del Impuesto sobre Determinados Servicios Digitales, Congreso de los Diputados, Madrid 2019.

334 Lampreave P. (2020), *Spain Has Approved the Digital Service Tax: The Controversy Is Served*, Wolters Kluwer, http://kluwertaxblog.com/2020/02/24/spain-has-approved-the-digital-service-tax-the-controversy-is-served/#_ftn1 [accessed 27.03.2020].

335 *Ibid*.

336 Bill defines it as follows: "Targeted advertising – any form of commercial digital communication with the purpose of promoting a product, service or brand, aimed at users of a digital interface based on the data collected from them. All advertising shall be considered as "targeted advertising", unless proven otherwise".

– Transfer of data gathered from users during their activity on a platform. Activity will be taxed when the data has been generated by users located in Spain, via a digital interface. When calculating the tax base, the ratio of transmitted data generated based on the activity of Spanish users to the total amant of users will be taken into account[337].
– Intermediation in a so-called peer-to-peer activity among users allowing them a mutual supply of goods or services. Subject to the taxation is dependent on meeting at least one of two conditions: the online transaction takes place using a device located in Spain or a user account was opened from a device located in that country. The key is not the place of actual execution of the transaction, but its "order" through a device located in Spain. The tax base will be calculated taking into account the proportion of Spanish users to the total number of users as well as the proportion of income from the number of open accounts in Spain to the total amount of income from the open accounts[338].

Some activities, such as financial services on a regulated market or services between entities within the group, having 100% direct or indirect ownership or common ownership, are excluded. Also, the scope of regulation does not cover the delivery of goods and services[339].

The bill sets out two thresholds used to determine whether there is a tax obligation:
– Global revenues of EUR 750 million,
– EUR 3 million of revenues from taxable services in Spain[340].

Revenues of the companies belonging to one group are calculated for the whole group. If thresholds are passed, companies are deemed to be a taxpayer. The tax rate is 3%. The tax accrual is immediate, following the provision of taxable services, with a quarterly tax return filed[341]. The tax

[337] Bill defines it as follows: "Data transmission services: transmission with consideration, including the sale or transfer, of those data collected about users, which have been generated by activities developed by the latter in digital interfaces." based on: *Ibid*.
[338] The bill defines it as follows: "Online intermediation services: services made available to users of a multifaceted digital interface (which allows interacting with different users concurrently) that facilitates the delivery of goods or services directly between users, or that allow them to locate other users and interact with them"; based on: *Ibid*.
[339] Ley del Impuesto sobre Determinados Servicios Digitales, Artículo 6.
[340] Ley del Impuesto sobre Determinados Servicios Digitales, Artículo 8.
[341] Ley del Impuesto sobre Determinados Servicios Digitales, Artículo 15.

base is calculated after excluding of VAT[342]. From a technical point of view, the user's geolocation will take place using the IP address.

The proposal also provides for the establishment of penalties. They relate to the failure in complying with the obligation to inform on how the amount was self-calculated. The fine is 0.5% of the total turnover but remains within the scope of minimum 15,000 to 400,000 euros[343].

The solution is supposed to be in force until an international agreement is reached. The preamble of the bill also indicates that the application of the regulations continues until Spain implements provisions of the European Directive, once such an act is in place. At future point, current Spanish regulation shall be withdrawn[344].

It should be emphasised that some negative opinions are expressed regarding various elements of the tax. For example, it is pointed out that, as an indirect tax, it will go beyond the application of double taxation avoidance treaties, to which Spain is a signatory. Consequently, double taxation problems may increase. Consideration is also given to the incompatibility of the idea regarding the narrow scope of taxation with the general directions of the OECD. In terms of geolocation of users, attention is drawn to a possible violation of the data protection regulations, as well as to problems with preventing the device from redirection and changing the location[345].

2.6. Poland

On 24 April 2019, the Multiannual State Financial Plan for 2019–2022 was adopted by the Council of Ministers[346].

342 Ley del Impuesto sobre Determinados Servicios Digitales, Artículo 10.
343 Ley del Impuesto sobre Determinados Servicios Digitales, Artículo 15.
344 Ley del Impuesto sobre Determinados Servicios Digitales.
345 Díaz-Súnico, G. (2019), *The New Spanish Digital Service Tax – A Strange Combination of Value Creation and Geolocalisation*, Bloomberg tax, https://news.bloombergtax.com/daily-tax-report-international/insight-the-new-spanish-digital-service-tax-a-strange-combination-of-value-creation-and-geolocalization [accessed 29.03.2020].
346 *Wieloletni plan finansowy państwa na lata 2019–2022,* Załącznik do uchwały nr 31 Rady Ministrów z dnia 24 kwietnia 2019 r., Warszawa.

The document consists of two parts:

- A convergence programme[347],
- Part defining the objectives of the main state functions alongside the measures of the degree of implementation.

In Annex 1, entitled "Key actions in the area of taxes for 2019–20", digital tax is placed among the "systemic changes" planned to be implemented from 2020. The amendment is called "taxation of digital enterprises". As part of the chapter entitled "Key actions in the area of taxes", section 5.2 is devoted to the digital tax issue.

The addressees of future regulations were identified as the largest digital enterprises providing digital services in Poland. Its purpose is to tax the turnover (not the income) of these digital enterprises[348].

While justifying the proposal, the needs arising from the current digital economic realities and the non-adaptation of existing tax solutions to the digital reality were pointed out. An indication was made about ongoing work in this area internationally, evoking that due to the uncertainty of the future regulation within the OECD forum, many countries consider temporary regulation of digital activities. The annex stated that the initial report of the OECD, published in March 2018, also contributed to this trend. It provided guidelines for the creation of such solutions at national level so they can comply with international tax rules and be efficient[349]. The European Commission's draft directive of 2018 also contributed to possible interim regulations[350].

The tax revenues estimated for 2020 would, according to previsions, amount to PLN 217.5 million. The basis of this estimation are two financial forecasts:

- the European Commission report covering the EU's digital service tax revenue forecast for 2019[351],
- forecast of 2019 CIT income in Poland, set out in the Budget Act for 2019 (PLN 34.8 billion)[352].

[347] Required according to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, Brussels 1997.

[348] *Wieloletni plan finansowy państwa*, pp. 60–61.

[349] OECD (2018), *Interim Report*.

[350] European Commission (2018), Proposal for a Council Directive 2018/0072(CNS) and European Commission (2018), Proposal for a Council Directive 2018/0073(CNS).

[351] European Commission (2018), *Impact Assessment*, pp. 69–70.

[352] *Wieloletni plan finansowy państwa*, p. 61.

According to the information from the Ministry of Finance, the draft of the Polish bill on digital tax provided for setting out the digital tax classified as indirect, compatible with current VAT rules[353]. Given the features, it shall constitute a hybrid, bearing also certain characteristics of the direct taxation. However, the intention was that it would not fall into the scope of the double taxation regulations.

The project was based on the proposals elaborated by the European Commission in 2018[354]. The scope of taxation was wide and covered the following activities:

1. Targeted advertisement services – in that point, the Polish proposal built on the European concept, while widening the meaning of that term in comparison to other national proposals. It consisted of both profiling activities, namely the activities based on the user's profile, as well as contextual activities, covering the placement of advertisement in a given context, i.e. according to the website consulted by the user. This differentiation was dictated a.o. by the attempts of capturing the whole distribution chain in the process of value creation concerning the activities referred to as an online-advertisement business[355]. It is also worth mentioning that this category is supposed to cover the actions concerning every way of capitalising on user's data collection activities.

   The tax shall be levied when the user is located in Poland. To determine this localisation two independent tools might be used. Firstly, geolocalisation to determine where the ad is displayed by pinpointing the IP address. Secondly, to render the determination more effective, the place in question could be determined referring to data on the user's permanent residence whereabouts along with other data provided by the user to the platform[356] .
2. Digital intermediation services – this category would include a wide range of activities allowing the interaction between the users for the

[353] All information provided for on the project of the Polish Digital Tax are based on the interview with the representative of the Ministry of Finance, conducted by the author on 28 March 2020.

[354] European Commission (2018), Proposal for a Council Directive 2018/0073(CNS) on the common system of a digital services tax on revenues resulting from the provision of certain digital services, Brussels and European Commission (2018) Proposal for a Council Directive 2018/0072(CNS) laying down rules relating to the corporate taxation of a significant digital presence, Brussels.

[355] I.e. covering not only publishing activities but also ad exchanges.

[356] For example data extracted from the invoices, registration forms, delivery details etc.

provision of services. It also applies to any kind of preparatory activities aiming at the ultimate establishment of the legal contract between the users as well as the conclusion of contracts itself. The intermediation can befall in a variety of services where the undertaking of digital actions is of importance for the outcome and the successful conclusion of the legal contract[357]. In respect to that point, the taxable event shall be deemed to happen in Poland if at least one user is located therein.

3. Cloud data intermediation services – it refers to the access to ICT[358] resources against a fee. The characteristic of that point is that it mostly refers to Business-to-Business services. Alike the case of digital intermediation services, the presence of at least one party to the transaction in Poland is a condition for the taxable event to occur here.
4. Services providing access to digital content – the wide category evoking the activities of enabling the user's admission to digital materials positioned online. Services rendered to provide users with access to music, films, games, sports transmissions, etc. are the examples falling under the scope of this provision. Additionally, when determining the user's location for taxation, the spectrum of criteria is highly extended. Apart from the geolocalisation based on IP address, additional data on the user is to be taken into account in that respect. It relates, first and foremost to the place of the user's residence[359].

Subjected to taxation shall be businesses crossing two thresholds:

- worldwide turnover of at least 750 million euro,
- turnover in Poland arising from activities subjected to taxation of at least 10 million euro.

If the company is a part of the multinational group, the entity operating in Poland shall be obliged to comply with the obligations arising from the activities of all members of the group. In case the group or the company obligated to pay the tax has not had a representative for tax purposes in Poland, one shall be established. Whatmore, while examining if the group is subject to the Polish Digital Tax, the turnover of every entity constituting

[357] The big variety of activities in that category touches upon, for example, transport, storage, accommodation services etc.

[358] Information and Communications Technology.

[359] Such data shall be extracted from the platform in question. Users usually provided it to the platform for the purposes of registration, making a payement, etc.

the group is summed up. It refers to turnovers arising from every type of aforementioned taxable activities.

The tax base for the company shall be calculated in two steps. Firstly, the proportion between the number of Polish users and the number of worldwide users is to be established. The result is the percentage that Polish users constitute among all users worldwide. Secondly, this percentage shall be multiplied by the company's turnover arising from the activities subjected to taxation worldwide. The tax rate would assumably be set at about 3–4%.

It should be emphasised that a general concept of the Polish digital tax is to cover a wide scope of activities considered to be "digital". This approach aims to assure equal treatment and avoid selective taxation of a subjectively chosen type of business. The approach also fits into the context of work being carried out internationally to tackle the problem of under taxation of the digital economy as a whole.

Finally, digital tax has not been introduced by the present moment. At the beginning of 2020, the Polish Government representative emphasised that the most desirable solution would be the worldwide consensus, regulating digital taxation matters on the level of the OECD[360]. Nevertheless, the concept remains valid and may be picked up again during the months to come.

It is also worth to mention the multimedia fee initiated and adopted at the end of April 2020, colloquially called the "Netflix tax". It was proposed as one of the elements of the legal amendment to the protective measures in connection with the spread of the SARS-CoV-2 virus[361].

The fee applies to entities providing audiovisual media service on demand (so-called VOD). These entities are required to make a payment to the Polish Film Institute. For that reason, the provision does not meet the conditions necessary for recognising it as a tax under Polish law[362]. The amount of the payment is 1.5% of the revenue obtained by the entity from:

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[360] According to: https://podatki.gazetaprawna.pl/artykuly/1456056,koscinski-podatek-cyfrowy-oecd.html [accessed 15.04.2020].

[361] Draft bill amending some acts in the field of protective measures due to the spread of the SARS-CoV-2 virus, https://bip.kprm.gov.pl/kpr/bip-rady-ministrow/projekty-ustaw-przeslan/2887,Projekty-ustaw-przeslane-do-Sejmu-RP.html [accessed 10.05.2020].

[362] According to the Art. 6 of the Tax Ordinance Act (Dz.U. tłum. gb z 2019 r. poz. 900): Tax shall be a gratuitous, compulsory, non-repayable pecuniary performance made under public law in favour of the State Treasury, a voivodeship, a poviat or a gmina, resulting from statutory tax law.

– payements received against the viewers' access to audiovisual media services on demand, or
– the revenue obtained from the issue of commercial communications[363].

The basis for the introduction of this provision is the Audiovisual Media Services Directive (AVMSD)[364].

The settling of this fee is within public discourse often incorrectly considered as an introduction to the Polish legal order of the digital tax. This solution is only a measure under the relevant sectoral legislation, in no way exhausting the definition of "digital" in the sense given by the EU and the national projects described above in this chapter. At the same time, as presented above in this thesis (table 8) certain sectoral regulations in the field of cinematography, with particular emphasis on the VOD content, were introduced in some European countries well before the inception of the European discussion on the digital tax in the current form. They remain, however, independent public levies with separate characteristics and should not be confused with each other. Especially in the Polish case, since the Polish fee in its current shape cannot be qualified as a tax.

363 *Ibid*, art. 15.
364 Directive 2010/13/EU of the European Parliament and of the Council of 10 March 2010 on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the provision of audiovisual media services.

Conclusions

The legislation on taxation of digital activities and digital companies constitutes an interesting phenomenon of our times. As a general trend, calling for new regulations seems to be a natural step, once new genres of activities become broadly exercised. In this case, the new sort of commerce arose around endless possibilities provided by the development of the Internet. Companies can easily grow by using online platforms to take actions in the global scope, without additional boundaries and limits. They can both manage to develop their hitherto products and services in an unprecedented form and way as well as create new ones[365]. Besides, they can capitalise on new, accessory elements appearing in the process, that could not have been capitalised on before[366]. These trends are supported by the common sentiments of discrepancies between digital companies being treated favorably, and non-digital ones that cannot afford these "privileges".

At the same time, certain difficulties in imposing new regulations on the digital economy appear. On the one hand the precise nature of all regulations falling into the scope of the so-called "digital tax" lacks uniformity. As was indicated beforehand, regulations in current forms are hardly enforceable and often the states are running short with tools indispensable to measure tax obligations as well as thoroughly exercise their rights to collect taxes. Activities and assets supporting the digital economy are mostly intangible, therefore it is difficult to measure and capture them[367]. All means of measurement of that digital presence remain problematic to apply and are in its nature considered to be controversial.

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365 It relates to means such as P2P platforms, online selling etc.

366 Mostly, it involves data collected alongside the main process of selling goods/providing services. This bank of data, formerly collected in a "on the side" way, afterwards can be easily capitalised and taken advantage of as a separate process in itself i.e. aiming at selling the data out to third parties.

367 Such as the permanent establishment concept.

In my opinion, a few elements must be taken into consideration when discussing future legal resolutions regarding issues in question.

Regardless of which particular solution would be agreed upon and pursued, social consensus must be sought. This need is materialised on both, national and international levels. Internationally, any widely spread agreement should be honored by numerous countries, not solely the select ones. This problem is easily seeable inside both, the European Union and the OECD, where competitive interests disturb the long-lasting process of negotiations.

Additionally, worldwide agreements and solutions should be primarily sought after since the phenomenon of digital activity is global in its core. Without multinational cooperation, any actions pointed at collecting reliable data on digital companies' global turnover as well as forcing them to be eligible for their actions in a particular jurisdiction are more likely doomed to failure. Even legally imposed, taxes cannot be thoroughly and properly enforced in many cases. Also, tax calculation exercised in a given country is submitted to be based on highly alleged, assumed, and often declaratory sets of data about global financial results and activities of an international company. In some cases, the process of tax collection can be equally problematic as well. For these reasons, a common global solution and widely-spread consensus, possibly reached at the OECD level, is highly desirable.

At the same time, the external dialogue is important in regard to social and economic dimensions. After all, the worth noticing occurrence is that most of the concepts providing for "digital tax" solutions are based on a wide range of socially-driven sentiments of "tax unfairness" or "economic unfairness". It involves, among others, frequently stated opinions that digital companies take advantage of current tax provisions, avoiding taxation on a massive scale.

Simultaneously, citizens are becoming more conscious of the importance that their participation in social media and other platforms constitute a base of profits for digital companies. Particularly, in case of initiatives proceeded on the international level by the European Union and the OECD, the need to reestablish certain equilibrium is strongly punctuated. From that perspective, it appears to be especially important to define, what exactly equilibrium and tax fairness shall mean.

Since the "merchandises" creating the value of digital companies are nowadays often purely intangible assets, their valuation is troublesome.

Clarification of the subsequent steps for tax legislation in that respect, so the taxes may become more "fair", is desirable. The more so because the number of both "digital companies", as well as "digital activities" namely actions of economic importance taken online by any type of enterprises, will presumably be growing.

I believe that the long-term solution is reachable in the extended, complex process of negotiation, possibly within the OECD. The prompt success of that undertaking is uncertain. Nevertheless, having in mind the accelerated changes in technical and digital inventions, a wide-ranging debate is desirable. In the long term, the digital tax does not have to be perceived only as a dedicated, technical, and legal solution aimed at solving a narrowly defined problem. The discussions about it rather constitute certain postulate and requirement to closely follow the development of technology and to try to systematically adjust tax law as far as possible. In the end, the outcomes of that discussion can be interpreted and leading to the adaption of the accustomed solutions.

Another important constatation is that the scope of regulations, referred to as digital tax or taxation of the digital economy from the CIT perspective, remains open. Particular proposals, both implemented and postulated, present different views on what should be understood as "digital" in the first place. One must apprehend that new technologies appear now and then, in general steadily quicker throughout the last decades than before. Having that in mind, the necessity to lead a constant discussion and regular evaluation of tax provisions in the light of their accuracy in the modern world seems especially crucial. From another angle, it could also create an opportunity for certain compromises in the worldwide deliberations on the subject. Uncertainty towards the actual scope and meaning of the ever-changing term "digital" could be a ground for the creation of generalised policy guidelines, enabling further creation of more specific regulations with time.

Having said this, in my opinion, one must not see the attempts undertaken by several countries as negative and non-contributing to the ultimate solution. In fact, the opposite can be true to some extent.

Although the maladjustment of tax systems to certain aspects of reality is not a new phenomenon, this particular problem concerning the scale and importance of digitalisation is somehow new. It is not the sole presence of digitalisation but the fact of how far-reaching it becomes and how digitalised the world is and will be. Regulators all over the world, who decided to face that newly appeared issues, pave the way for other undertakings in the future, both locally and globally. The in-depth analyses of the outcomes and wider consequences that particular regulations brought to the national tax system can work as valuable information and provide for a lesson to learn.

For example, it may reveal the effectiveness of particular tools and mechanisms, implemented to measure the so-called "digital presence" in various legal versions of this term. It also demonstrates what the real enforceability of certain measures is, while offering insights into the most adaptable procedure for tax calculation and collection, as well as carrying plenty of additional information. Hence, the contemporary national efforts create a so-called legal sandbox for concepts and ideas.

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This thesis presents an analysis of legal solutions concerning taxation of the digital economy. The study covers activities aimed at adjusting international, European and national tax regulations to the current needs of the digital economy. The author discusses examples of solutions introduced in the field of a broadly understood digital tax. He also presents the impact that digitalisation of the economy has over different categories of taxes. The conclusions formulated at the end of the thesis indicate the actions necessary to take in order to establish proper tax regulations in the future.

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