EUROPEAN COMMISSION

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C(2018)5187 final

Dear Presidents,

The Commission would like to thank the Houses of the Oireachtas for their Reasoned Opinions on the proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence {COM(2018) 147 final} and on the proposal for a Council Directive on a common system of a digital services tax on revenues resulting from the provision of certain digital services {COM(2018) 148 final}.

The Commission would first like to recall the general context of the proposals and their objectives. The digital economy is transforming the way we interact, consume and do business, bringing many benefits to society. To fully seize its potential, the Commission has made the Digital Single Market one of its top priorities. Fair and effective taxation is essential to support the Digital Single Market to deliver on its potential. It is important to provide an updated tax environment in which digital activities are recognised at their right worth and in which digitally oriented companies can grow, benefiting from a predictable business environment and a level playing field.

Against this background, the Commission has identified as general objectives behind its initiative (1) the integrity and proper functioning of the single market, (2) the sustainability of public finances, (3) ensuring fairness and a level playing field for all business and (4) the fight against aggressive tax planning.

With these proposals, the Commission is also responding to the European Council Conclusions of 19 October 2017, which underlined the need for an effective and fair taxation system fit for the digital era and looked forward to appropriate Commission proposals by early 2018.

The Commission has taken due note of the concerns expressed by the Houses of the Oireachtas on the conformity of the proposed Directives with the principle of subsidiarity.

Mr Seán Ó FEARGHAÍL T.D.
President of Dáil Éireann
Houses of the Oireachtas
Leinster House
Kildare Street
IRL – DUBLIN 2

Senator Denis O'DONOVAN
President of the Seanad Éireann
Houses of the Oireachtas
Leinster House
Kildare Street
IRL – DUBLIN 2

In this regard the Commission would like to make the following observations.

The Houses of the Oireachtas express the view that the implications of the Commission's proposals pertain to tax policies and therefore impinge on a national competence. It should be clarified that tax policies constitute a policy area of shared competence between Member States and the Union and in this constitutional framework, the Union holds the authority to act in line with the principles of subsidiarity and proportionality.

The legal basis for the proposal on rules for a significant digital presence is Article 115 of the Treaty on the Functioning of the European Union. This provision stipulates that the measures of approximation under this article shall directly affect the establishment or functioning of the internal market.

One of the key aspects of digital businesses is that they can easily conduct activity remotely and are very active in cross-border trade. The problems posed by the current corporate tax framework not keeping pace with the new features of the digital sector are not particular to a specific Member State, but constitute a common challenge for the European Union as a whole. In fact, such problems are of an international dimension because they are rooted in the international tax framework and concern cases where digital activities are performed cross-border.

The Commission finds that a common initiative across the internal market is required for a direct and harmonised application of the rules on a significant digital presence within the Union to ensure a level playing field for all Member States and to provide taxpayers with legal certainty. Unilateral and divergent approaches by each Member State could be ineffective and fragment the single market by creating national policy clashes, distortions and tax obstacles for businesses in the European Union. If the objective is to adopt solutions that function for the internal market as a whole, the appropriate way forward is only through coordinated initiatives at the level of the European Union.

European action would be more effective and efficient than different national policies, as it would entail a reduction in the compliance burden for businesses subject to the new rules. Instead of fragmenting the market and adding cross-border tax obstacles to today's tax systems through unilateral measures, a coordinated European action would ensure that the issue is addressed without hurting the single market and its competitiveness. Uncoordinated action targeting the digital sector would undermine the existing work at European level on the wider corporate taxation rules.

The legal basis for the proposal on a common system of a digital services tax is Article 113 of the Treaty on the Functioning of the European Union. This provision enables the Council, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the European Economic and Social Committee, to adopt provisions for the harmonisation of Member States' legislation concerning 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.

A common and coordinated action at Union level to reform the corporate tax framework to cover the digital activities of companies is likely to take time. In the meantime, Member States may introduce unilateral interim measures to address the challenges of taxing the digital economy companies. Some of these measures, which can be of a very diverse nature, are already in place or are being planned by Member States. As explained in the impact assessment accompanying the proposal, these national experiences vary significantly, and it is unlikely that, without a certain degree of coordination, the different Member States concerned will follow a common approach. Uncoordinated national actions create complexity, contribute to distortions in the single market and enhance the risk of double taxation. In this respect, European action is necessary in order to mitigate the fragmentation of the Single Market and the creation of distortions of competition within the Union which may result from such divergent unilateral actions at national level.

A European solution adds value compared to different national policies because it entails a reduction in the compliance burden for businesses subject to the new rules and also gives a strong sign to the international community as to the commitment of the European Union to act when it comes to ensuring the fair taxation of the digital economy. Moreover, common interim measures rather than divergent national ones will facilitate finding comprehensive solutions in the future.

On that basis, the Commission finds that the proposal complies with the subsidiarity principle.

In response to the more specific comments in the Reasoned Opinions, the Commission would like to refer the Houses of the Oireachtas to the attached annex.

The Commission hopes that the clarifications provided in this reply address the issues raised by the Houses of the Oireachtas and looks forward to continuing our political dialogue in the future.

Yours faithfully,

Elżbieta Bieńkowska
Member of the Commission

ANNEX

The Commission has carefully considered each of the issues raised by the Houses of the Oireachtas in its Reasoned Opinions and is pleased to offer the following clarifications.

1. Points relating to both proposals

Timing of proposals and link with G20 / Organisation for Economic Cooperation and Development (OECD) work on taxation of the Digital Economy

The Commission is fully supportive of work underway at G20/OECD level and agrees that the solution to effective and fair taxation of the digital economy should ultimately be a global one.

However, so far, progress at international level has proven to be challenging and Member States are under increasing pressure to take action. Some are already introducing unilateral measures. The introduction of a range of different national measures risks fragmenting the single market, places additional burdens on businesses and reduces the chance of agreeing on a common approach in the future.

The Commission does not share the view that putting forward a proposal will lead to the emergence of divergent and incompatible taxation models. The Commission's proposals take into account the findings and principles set out in the OECD's interim report. It is the Commission's aim that the European proposals will provide inspiration and impetus for the ongoing international work on digital taxation, steered by the G20/OECD.

Administrative burden

While there would be some additional administrative costs for both businesses and national administrations in implementing the proposals, this would also be the case if Member States were to implement a patchwork of different national measures. The fact that a European solution rather than different national policies is put forward would entail a reduction in the compliance burden for businesses subject to the new rules. As regards the Digital Services Tax, the Commission is proposing the use of a One Stop Shop in order to reduce the administrative burden.

2. Points relating to the proposal on significant digital presence

Design of the proposal on the significant digital presence

The Commission does not share the view that the proposal on corporate taxation of a significant digital presence proposes a narrow solution. It provides a solution to the challenges of fair and effective taxation of the digital economy within the framework of the existing international corporate tax system. It focuses on digital services, as the particular characteristics of these services (such as the user contribution to value creation) are not well covered by the existing corporate taxation rules.

Method of allocation of profits to a significant digital presence

The proposed rules on the allocation of profits are based on the current framework applicable to permanent establishments, which looks at the risks managed, the functions

performed and the assets used by a permanent establishment. They include additional tests to better reflect how value is created in digital services. This is distinct from the formulary apportionment proposed as part of the common consolidated corporate tax base, and aims to reflect the fact that much of the value for businesses supplying digital services is created where users are based and data is collected.

The proposed Directive only sets out the general principles for allocating profits to a significant digital presence in order to allow more detailed guidelines to be developed at the appropriate international fora or at European level.

Need to renegotiate Double Taxation Agreements

Once adopted, the Directive would apply to companies based within Member States or in tax jurisdictions with which there is no double taxation agreement. However, it would not apply where a Member State has a double taxation Agreement with a tax jurisdiction outside the European Union. In order to avoid disrupting the level playing field between European Union and non-European Union businesses, the Commission has also adopted a Recommendation to Member States[1] to change the definition of permanent establishment in their tax treaties and include rules on attributing profits to a significant digital presence, in line with the proposals. The Commission stands ready to assist Member States in taking a common approach to negotiating changes in their double taxation treaties with non-European Union jurisdictions in order to reduce the administrative burden.

3. Points relating to the proposals on a digital services tax

Design of the digital services tax and effect on small and medium enterprises and start-ups

The digital services tax has been conceived as a temporary solution that addresses the loss of revenues of Member States – to be applied across the board to the entire population of taxpayers, as defined in the directive. It does not target any individual companies, any sector or any nationality. The digital services tax is designed in a way that it does not effectively exclude European companies. The proposal should therefore not be construed to be arbitrary or discriminatory.

It is indeed designed as a tax on turnover from specific digital services and does not have specific provisions for loss-making companies. Normally, this might be the case for younger companies that – during their first years – go through an explosive phase of building their user base, in order to be able to compete with the large market players. However, the proposed digital services tax provides for two thresholds, which are likely to exclude such companies from the scope of the tax. Nevertheless, if this issue were to be flagged as crucial by several Member States, the Commission would be open to discussing with the Council the need for mitigating any negative effects of digital services tax on loss-making companies. The thresholds proposed would exclude small and medium enterprises from the scope of the tax.

[1] C (2018) 1650 final

Single rate

As explained in the impact assessment accompanying the proposal[2], the policy choice of using a single rate throughout the Union was made mostly for legal reasons, having in mind the case law of the Court of Justice of the European Union (notably, the Hervis Sport case)[3]. However, during the Council discussions, alternative solutions could be explored, for instance in the form of an interval. In any case, such alternative solutions need to take into account that a low rate (e.g. 1 or 2%) would raise questions about the financial feasibility of the tax (tax revenues net of compliance and administrative costs), while a high rate (e.g. 5 or 6%) would imply a higher burden, especially on companies with low profitability.

Calculation of the estimated revenue from the digital services tax

The impact assessment provides the details on the business models affected by the proposals. The Commission is not in a position to provide a list of companies falling under the scope of the proposals, as it is for the companies themselves to check if they meet the criteria. Some of the information needed for this is not available to the Commission but only to the companies themselves. The services of European Parliament, Council and Member States can conduct their own calculations with respect to the implications of the two Commission proposals for directives.

Annex 8 to the impact assessment accompanying the Commission's proposals provides detail on the methodology used to arrive at the revenue estimates for the Digital Services Tax. These estimates were derived from a top-down methodology based on data and forecasts published by Statista on revenue in different digital markets.

Lack of an expiry clause in the digital services tax

The Commission has indeed chosen not to propose an expiry clause for the Directive on Digital Services Tax, as a reference to the adoption date or entry into force of the Directive on significant digital presence would not provide enough legal certainty. Certain alternatives are already being discussed in Council with the help of the respective Legal Services.

Double taxation

Regarding the potential double taxation generated by the Digital Services Tax, recital 27 of the proposal states that '[...] it is expected that Member States will allow businesses to deduct the Digital Services Tax paid as a cost from the corporate income tax base in their territory'. Actually, based on Article 113 of the Treaty on the Functioning of the European Union, the proposed Directive aims at harmonising national actions, which – left uncoordinated – could aggravate the current situation, further contributing to distortions in the single market and the risk of double taxation (or double non-taxation).

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[2] SWD(2018) 81 final/2

[3] Judgment of the Court (Grand Chamber) of 5 February 2014, Case C-385/12 (Hervis Sport) – OJ C93, 29.3.2014.