RIGA GRADUATE SCHOOL OF LAW

Digital Age and Corporate Taxation. European Union on the way to create a unilateral digital taxation regime.

BACHELOR THESIS

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DECLARATION OF HONOUR:
I declare that this thesis is my own work, and that all references to, or quotations from, the work of others are fully and correctly cited.

(Signed) ……………………………………

RIGA, 2019

ABSTRACT

The digitalization of the economy has rapidly changed the outlook of the business models today. It is no longer necessary for an entity to be located within a country to generate enormous amounts of revenues deriving from it. At the same time, the corporate taxation principles have not changed in order to adopt to this situation- when establishing the place of taxation they do not take into the consideration where the consumers are located. Thereby, an unfair treatment towards Member States has been created as today large revenues for big tech companies can be created within their territory without having a burden to pay a tax.

Answering to the global discussion the European Commission has created two proposals for the Directives with an intention to tax digital companies. Understanding elements that would change after the Directives are implemented is at utmost importance, as they would re-create the way how the corporate taxation system functions within the time of the digitalization of the economy.

This thesis analyzes the differences between the Directives paying special attention towards the determination of the taxable persons, taxable revenues and the territorial scope. Additionally, the possible problems deriving from both proposals for the Directives will be analyzed.

SUMMARY

The way how the business models operates has changed within last years at a rapid speed. Companies have become more and more digitalized thereby allowing businesses to obtain significant amounts of revenues from countries without being physically present within their territory. At the same time, corporate taxation rules have proven to be outdated as when establishing the place of taxation they still consider the place of a physical presence as being the main aspect. Thereby, a situation of an unfair treatment towards majority of Member States have been created as today they can have a large scale tech business gaining revenues from their territory without paying any corporate taxes.

Answering to this global issue, the European Commission has created two proposals for Directives targeted at the big tech companies with an intention to create a fairer taxation system in the time of the digitalization. The author considers the discussion of how both Directives would look as a highly important topic within todays corporate taxation system as the Directives would change it significantly. Additionally the author outlines that is significantly important to acknowledge the contents of these Directives as soon as possible in order to understand their nature and possible problems deriving from them in advance. As a result, this thesis analyze the contents of the Directives and outlines the possible issues deriving from them.

Correspondingly, the first proposal for a Directive is meant to re-create the principle of how and where the value is created by re-defining concept of a permanent establishment. Instead of defining the place of permanent establishment by looking for a Member State where an entity has a physical presence, the Directive will attribute the permanent establishment to a country where an entity has a significant digital presence. Significant digital presence will be considered to be within a Member State if throughout a year if the taxable revenues deriving from a Member State exceed 7 million euros or if there are more than a hundred thousand users within a Member State, or if within a Member State more than three thousand contracts for digital services have been concluded. Additionally, the Directive provides a wide definition of the services with a digital element that will be considered as being taxable.

However, as the European Commission has acknowledged that the existing problem is outstanding and requires a quick reaction from legislators in solving it, the second proposal for a Directive was implemented. This Directive would work a quick-fix and would be applicable up until the long-term plan would be entered into force. The interim measure establishes a new tax- digital services tax- at the rate of 3%. Tax would be applicable to businesses obtaining revenues from online placement of advertising, for digital platforms facilitating interactions between users and for the sale of a user data. Moreover, the Directive establishes that a person would be deemed to be taxable if the amount of annual worldwide revenues would exceed 750 million euro and the total amount of the annual taxable revenues deriving from the European Union would exceed 50 million euros. If an entity would meet these requirements, it would be considered as a taxable person and it would be responsible for a tax burden in Member States from whom they have received revenues deriving from the services treated as taxable services.

At the same time, it has been acknowledged that the Directives also bear multiple issues that have been found and analyzed discussed throughout this thesis. These issues include such aspects as a difficult compliance process on behalf of entities, possible rights breached towards the targeted entities and a situation of an unfair treatment towards the smallest Member States.

All in all it can be observed that the European Commission has created a good basis for taxing multinational digital companies, however the European Union still have to “upgrade” them in order to ensure a truly fair system from targeted entities and the governments on Member States perspective.

Key words: *digitalization, corporate taxation, digital services tax, DST Directive, significant digital presence, SDP Directive, European Union, Amazon, significant digital presence.*

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LIST OF ABBREVIATIONS

AWS	Amazon Web Services
BEPS	Base Erosion and Profit Shifting
CIT	Corporate Income Tax
DST Directive	Proposal for a COUNCIL DIRECTIVE on the common system of a digital services tax on revenues resulting from the provision of certain digital services
DST	Digital Services Tax
DTT	Double Taxation Treaty
EC	European Commission
EP	European Parliament
Etc.	et cetera
EU	European Union
EUR	euro
G20	A international forum for the governments and central bank governors from Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, the United States and the European Union
GDP	Gross domestic product
GDPR	General Data Protection Regulation
HQ	Headquarters
i.e.	that is to say
IP	Internet Protocol
LLC	Limited Liability Company
m	million
MS	Member State
OECD	The Organization for Economic Co-operation and Development
PE	Permanent Establishment
SDP Directive	Proposal for a COUNCIL DIRECTIVE laying down rules relating to the corporate taxation of a significant digital presence
TFEU	Treaty on the Functioning of the European Union
The Council	the Council of the European Union
UN	United Nations
VAT	Value Added Tax

INTRODUCTION

> Digitalization brings countless benefits and opportunities but it also requires adjustments to our traditional rules and systems.[1]

Every country is responsible for the well-being of its residents and one of its main duties is ensuring a qualitative education, social security, transportation system, hospitals and other benefits that today we might see as something unquestionable and self-evident. In order to cover all related expenses, governments collect taxes that in average create 90% of their total revenues.[2] Thereby, it can be easily concluded that if governments want to expand their spending, they will be interested in collecting taxes, furthermore this interest should also lay within the citizens as they will be the ones enjoying the benefits.

Presently when determining where a company will be taxed, the attention is paid on a place where a company is located (it must be noted that these principles differ from country to country). This is a very convenient pattern as the customers from the most of the "traditional" companies are usually located in the same place as the business providing goods or services is. For example, if a company has a shop in Germany then it will also reach its customers in Germany, thereby the revenues will also flow from Germany and following the legislative acts, the profits will be subjected to CIT in Germany.

However, today the situation is not as easy as it was at the time when the CIT rules were created- today the economy is digitalizing at a rapid speed, thereby creating many new and completely different businesses models such as Amazon, EBay, Spotify, Uber and others. These businesses are concluding their business activities on digital platforms or interfaces, thereby allowing them to obtain large amount of revenues without even being located within the country where they are providing the services. Additionally, these digital business have a "direct" access to a larger market (consumer simply have to access their web page or app) thereby creating a higher possibility for these business for generating more profits than brick and mortal businesses.

However, it has been discovered by the EC because of the current taxation rules the cross-border digital business models are being taxed with an effective average tax rate of only 10% while other businesses are subjected to the effective rate of 23%.[3]

This situation has occurred as the digital businesses have an opportunity to provide services to customers without being physically located within the country where a consumer is located.[4] As a result, by following the current CIT rules, a digital business will pay its tax

[1] The European Banking Federation. Quote by the Commission Vice-President Valdis Dombrovskis, responsible for Financial Stability, Financial Services and Capital Markets Union, available on: https://www.ebf.eu/priorities/digitaltransformation/taxation-of-the-digital-economy/. Accessed April 20, 2019.
[2]Eurostat. Tax revenues statistics, available on: https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Tax_revenue_statistics. Accessed March 6, 2019
[3] ZEW. Effective Tax Levels Using the Devereux/Griffith Methodology: Final Report 2016, available on: https://www.zew.de/en/publikationen/effective-tax-levels-using-the-devereuxgriffith-methodology-final-report-2016/. Accessed April 2, 2019.
[4] CFE Fiscal Committee. "Opinion Statement FC 1/2018 on the European Commission Proposal of 21 March 2018 for a Council Directive on the Common System of a Digital Services Tax on Revenues

only in a country where it is located leaving countries whose residents received their services or goods (i.e. generated revenues for the respective businesses) with no tax. This is a very significant problem with a great magnitude of consequences, as with such tax regime many countries are left without taxes that they reasonably thinking would deserve.

It must be outlined that the problem researched within this thesis is not digitalization of the economy itself. We need our economy to become more and more digitalized as it is borderless; it makes it easier for businesses to act globally; these businesses can engage with a customer without physical presence in the country where customer is located and therefore it creates new sources of revenues for the business.[5] The main problem lies in the fact that *the current corporate taxation system within the European Union is outdated, thereby creating an unfair treatment regarding revenues deriving the digital businesses*.

For that reason, there has been a global discussion of the necessity to create a cohesive treatment regarding taxation of digital businesses. Finally, inspired by such institutions as the OECD and G20, the EC has created proposals for two brand new directives that will create a common taxation system for digital businesses.[6] One Directive would work as a quick-fix creating a brand new digital services tax (hereinafter referred to as "DST"), while the second Directive would re-create the concept permanent establishment (hereinafter referred to as "PE") paying attention toward the aspect of where the user is located rather than by looking at the location of the entity itself. As these Directive will completely change the corporate taxation system within the EU, it is highly important to discuss them in more detail.

The main **research question** raised by this research is: "*How will the Directives proposed by the European Commission change the corporate taxation system in the time of digitalization and what problems they might cause?"*

This thesis consists of three parts. In the first part the author will describe the necessity for the need to change the taxation system including the analysis of the current corporate taxation rules and the main issues arising from them. The second part will be contributed to the discussion of the content of both Directives proposed by the EC. The second part will analyze the Directives through three main aspects- what will be taxed (the tax base), who will be taxable (taxable person) and where will be taxable (territorial scope), additionally by the end of this part author will analyze the possible differences in the tax treatment by discussing revenues obtained by *Amazon*. Lastly, the thesis will provide analysis of the main problems that the Directives might cause for the targeted persons and the governments.

Methodology

Resulting from the Provision of Certain Digital Services" in *European Taxation August 2018*, available on: https://research.ibfd.org/collections/et/printversion/pdf/et_2018_08_cfe_1.pdf Accessed on April 12, 2019.

[5] Brian J. Arnold, *International Tax Primer. Fourth Edition*, (The Netherlands: Wolter Kluwer, 2019), p. 221.

[6] European Commission. Fair Taxation of the Digital Economy, available on: **https://ec.europa.eu/taxation_customs/business/company-tax/fair-taxation-digital-economy_en** . Accessed April 15, 2019.

The research paper is based on qualitative analysis of the observed information regarding the Directives proposed by the EC and opinions outlined by several tax experts. Furthermore, the thesis will also include an element of comparative analysis while comparing the tax treatment under the Directives.

Limitations

This thesis will focus specifically on the CIT issues rather than ones deriving from other types of taxes, furthermore it will not include aspects related to the tax planning or tax avoidance.

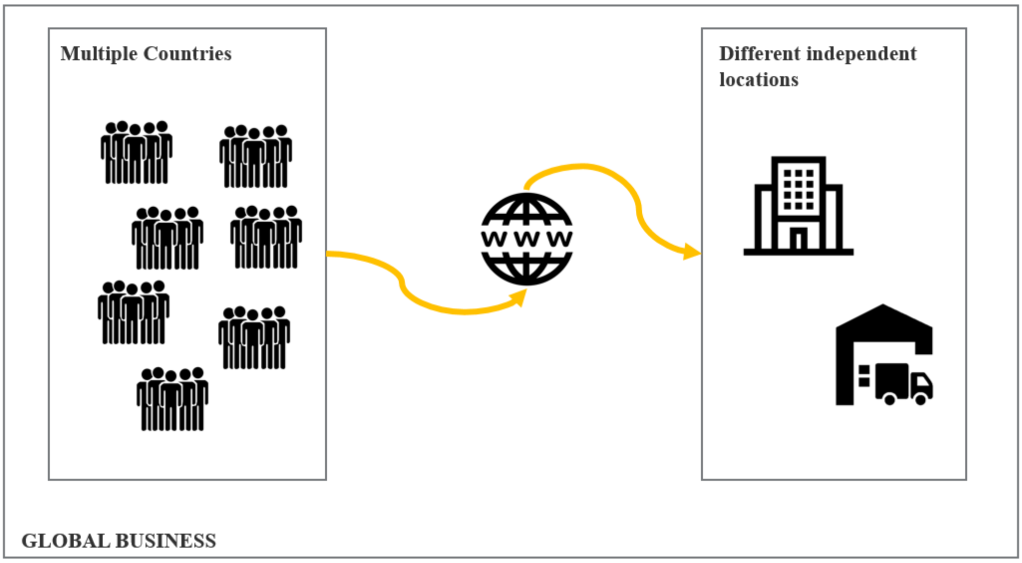
1. THE URGENT NEED FOR A CHANGE- WHY, WHERE AND WHEN

1.1. How the digitalization of the economy has changed the business models?

Digital technologies have changed our lives significantly and it seems that they will continue expanding. Everyone is talking about businesses going digital, new digital companies and digitalization as such. Without any doubt, one could say that people obtain digital services on daily basis- by listening to music on Spotify or iTunes, by ordering a taxi via Uber, by purchasing some items in web pages, by posting a picture in Facebook, by sending an email or a simple text message via WhatsApp or by using google. New businesses focusing on digital economy are being created on daily basis, moreover the existing businesses tend to become digital. Consequently, it can be concluded that this digitalization has changed the outlook of how the businesses and therefore economy looks and operates.

There is a reason why “digitalization” is so admired and attractive- it simply makes life a lot easier for consumers and businesses. Because of digital technologies, businesses can interact with their customers directly and without any “time limits”. Most of digital services are accessible twenty-four seven thereby leading businesses to a possibility to earn profits without “closing a shop for a night” or without having a day-off during holidays. What makes it more incredible, customers do not have to leave their homes to obtain these services, and on top of that they usually are able to access service providers from all round the world. As a result, also businesses have a possibility to obtain a market on a larger scale- without being limited to stay within boarders of a specific country. Therefore, digitalization not only makes our life easier and more accessible, but it also provides many new possibilities for businesses as it enables them to spend less while generating profits at higher speed.

As a consequence of the digital economy allowing its businesses to freely operate within many countries while not actually being located in them (see table below), the question of how these companies are being taxed may arise. In fact, in the recent years a public debate of whether digital businesses are taxed fairly has taken place. A reason for that is the fact that the model of how the businesses operate has changed significantly while taxation rules have stayed the same as before the digitalization took place. Thereby as digitalization gets, more and more incorporated within the economy, the taxation rules should also correspond with similar actions.



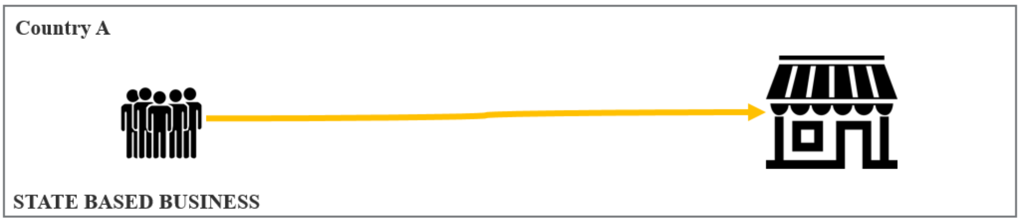


Table 1: Comparison between state based brick and mortal businesses and digitalized global businesses[7]

Simply discussing a fact that these digital companies can work without stopping, leads to a conclusion that these businesses are more efficient than the old and usual brick and mortar companies. One might wonder that non-digital companies receive a support from governments to be able to keep on moving, however somehow the situation has been created where these businesses stand in a better and more beneficial position than brick and mortal businesses do.

> The digital economy is characterized by an unparalleled reliance on intangible assets, the massive use of data (notably personal data), the widespread adoption of multi-sided business models capturing value from externalities generated by free products, and the difficulty of determining the jurisdiction in which value creation occurs.[8]

At the same time, it is believed that separating the digital economy from other is not the best idea. To begin with, it has been outlined that the only difference between the digital economy and traditional one is the presence of technologies, furthermore it has been argued that there is no significant difference between Airbnb and hotels; between Netflix and TV channels and regular taxis and Uber.[9] Nevertheless, it must be remembered that businesses participating in the digital economy has got a huge advantage as their business models make it easier to

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[7] *Created by author, icons are obtained from the sources of internet.*
[8] Thomas Pogge and Krishen Mehta, *Global tax fairness* (The United Kingdom: Oxford University press, 2016), p. 267.
[9] Martti Nieminen, "The Scope of the Commission's Digital Tax Proposals," in *Bulletin for International Taxation (volume 72),* (International**:** IBFD, 2018), p. 667. Available on: https://research.ibfd.org/#/doc?url=/collections/bit/html/bit_2018_11_int_1.html. Accessed March 2, 2019.

operates and expand, additionally they do not require a physical presence within every country where they operate. Because of that, the OECD has established the possibility of these businesses moving towards monopoly or oligopoly positions.[10]

1.2. Current corporate taxation system

> "[T]axation governs one of the most "intimate" attributes of sovereign power, contributing in a decisive way to the characterization of the same power under an ideological profile.[11]"

If in the other areas of the EU, protection of EU freedoms is strictly governed with the regulations, therefore making the domestic laws similar between one MS to another, then regarding taxation systems the EU has left a very wide margin of appreciation to the MS themselves. As a reason for not having regulations within the matter of taxation is that the implementation of a regulation regarding taxation would lead to an obligation for a MS to implement it without having any opportunity to make any adjustments in a way that it would suit the specific country. Hence, a possibility for a MS to establish the functioning of an internal market would be taken away. This has been established in the Article 115 of Treaty on the Functioning of the European Union[12] (hereinafter referred to as "TFEU") where it states the following:

> [T]he Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market.[13]

As a result, there do exist EU Directives such as Parent-Subsidiary directive[14], Merger Directive[15], Anti-Tax avoidance directive[16] and others guiding the MS in the right direction while implementing their own domestic taxation laws and giving these MS a room to implement legal norms in their legal systems in whatever way they decide to. Beyond shadow of a doubt, activities to reach these goals cannot go against the principle of supremacy-

[10] OECD, *Action 1 Final Report 2015- Addressing the Tax Challenges of the Digital Economy* (OECD: International Organizations Documentation IBFD, 2015), p. 11

[11] Pietro Boria, *Taxation in European Union*. *Second edition* (Switzerland: Springer, 2017), p. 31

[12] Treaty on the Functioning of the European Union (Consolidated version 2012), OJ C 326, 26.10.12. Available on: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A12012E%2FTXT . Accessed March 20, 2019

[13] Ibid.

[14] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (recast), OJ 345, 28.12.2011. Available on: https://eur-lex.europa.eu/legal-content/GA/TXT/?uri=CELEX:32011L0096 . Accessed April 10, 2019.

[15] Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States, OJ L 310, 25.11.2009. Available on: https://eur-lex.europa.eu/legal-content/GA/TXT/?uri=CELEX:32009L0133 . Accessed April 10, 2019.

[16] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193, 19.7.2016. Available on: https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A32016L1164 . Accessed April 10, 2019.

Member States must follow and promote values and rights set out by the EU. [17] In that way the EU ensures the principle of proportionality as by creating different taxation regimes Member States have the ability of achieving their own goals.[18] At the same time there do exist some recommendations for countries of how to build up their taxation regimes such as the OECD Model Tax Convention[19] and UN Model Tax Convention[20] from what almost all DTT are based on.[21]

As taxation rules are being governed by Directives, MS will have slightly different taxation laws between one and another, thereby multinational companies must take into the consideration different taxation regimes as they might be subjected to CIT in more than one MS. However, before complying with each MSs taxation regime where the company generates its revenues from, it is important to understand whether at all it will constitute as a taxable person there i.e. whether it will be responsible for CIT calculations and payment. Whether a company is taxable for CIT purposes within a country or not derives from the CIT law in that specific MS and mostly they are concerned about where the company itself is physically located. Usually a MS indicates that an entity either is subjected to a CIT if it is a domestic company or if it has a permanent establishment (hereinafter referred to as "PE") within a MS (see table below).

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[17] Christiana Hji Panayi, *European Union Corporate Taxation Law* (United Kingdom: Cambridge University Press, 2013), p. 5.

[18] Claudia Sano, *National Legal Presumptions and European Tax Law* (The Netherlands: Kluwer Law International BV, 2018), p. 81.

[19] OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017, (*OECD Publishing, 2017). Available on: http://dx.doi.org/10.1787/mtc_cond-2017-en . Accessed January 2, 2019.

[20] United Nations. Model Double Taxation Convention between Developed and Developing Countries 2017 update (New York, 2017). Available on: https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf Accessed April 10, 2019.

[21] Oats A Miller, *Principles of international taxation: fourth edition.* (London: Bloomsbury Publishing PLC, 2014), p.766.

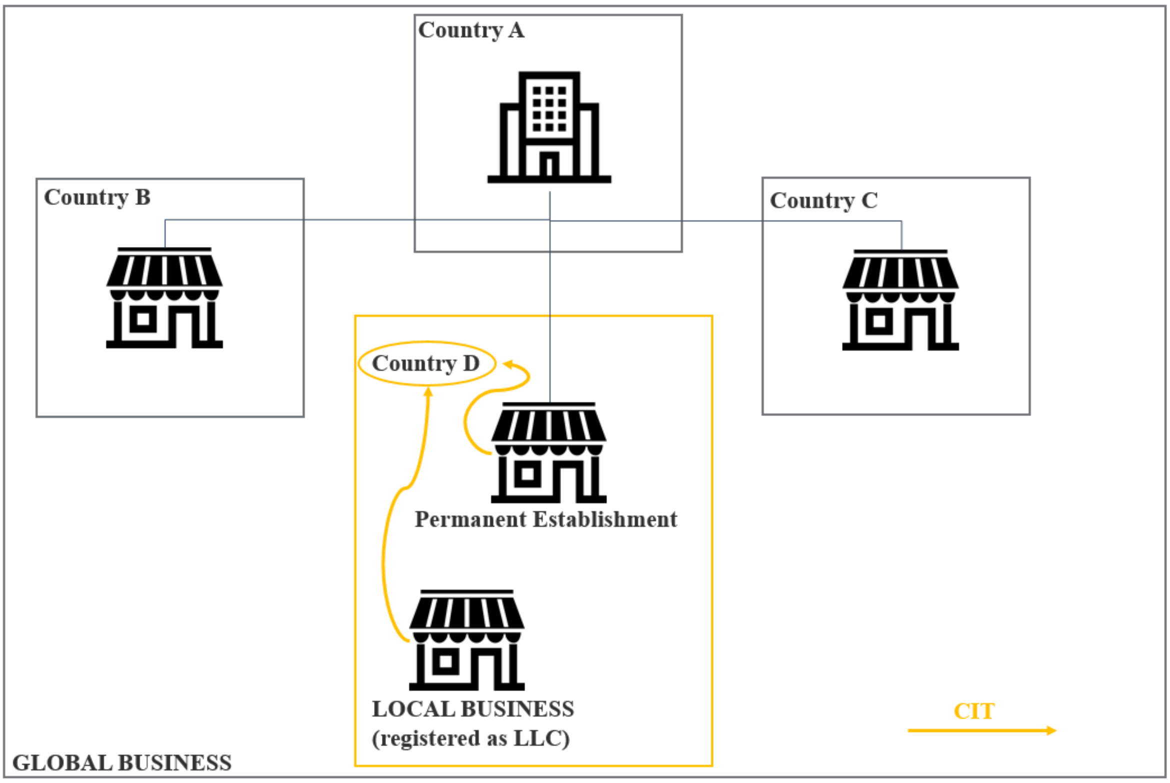

Table 2: Comparison between local entity registered as a LLC and a PE[22]

As it can be concluded from the table above, the PE and the resident enterprise are treated similarly- they both are located within the same country and they both are paying CIT towards the country in what they are located in.[23]

According to EU Interest and Royalty Directive[24] and the Parent Subsidiary Directive, an entity will be considered as having a PE within a MS other than where it is domiciled or registered for taxation purposes, if it will have:

> a **fixed place** of business situated in a Member State through which the business of a company of another Member State is wholly or partially carried on.[25]

Accordingly, following these directives also MSs within their taxation rules have created similar provisions regarding the determination of a PE. For example, under Latvian Law on Taxes and Duties a company would be considered to have a PE if it (1) has a **fixed place** of business within Latvia; (2) this place of business is being used or is meant to be used permanently and (3) if this place is being used for performing an economic activity.[26]

[22] *Created by author, icons are obtained from the sources of internet.*
[23] Emily Fett, *Triangular Cases. The Application of Bilateral Income Tax Treaties in Multilateral Solutions* (The Netherlands: IBFD, 2014), p. 173
[24] Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, OJ L 157, 26.6.2003. Available on: https://eur-lex.europa.eu/legal-content/GA/TXT/?uri=CELEX:32003L0049 . Accessed April 20, 2019.
[25] Ibid.
[26] Law on taxes and duties (Par nodokļiem un nodevām) (1 April 1995). Available on: https://likumi.lv/ta/en/id/33946-on-taxes-and-duties . Accessed April 20, 2019.

Furthermore, a PE could also be regarded as being located within Latvia if the respective entity is using a building, employees or equipment located within its territory.[27]

It can be observed that currently, a requirement when determining the presence of a PE within a MS includes a "fixed presence" within this country. A word "fixed" within this definition requires a " link between the place of business and a specific geographical point".[28] Thereby if an entity is operating on a global level, then in countries where it is not registered for taxation purposes or is not domiciled, it will be responsible for CIT payment if it will be carrying business activities through a fixed place within this country- in order words current system will look for a MS where this entity has a "physical presence".

A requirement for physical presence would work perfectly for brick and mortar companies having physical establishments within MSs (such companies as disclosed in the table above), however as the economy is digitalizing there now exist companies that can gain large revenues from a MS without even falling under the requirement of a physical presence (see table below). Thereby, two significant issues have been outlined by the EC when discussing current CIT laws- firstly current taxation rules do not take into account the amount of "value generated" between MS while distributing taxes and secondly the fact that a possibility of customers being located in a MS where the company is not physically established.[29]

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[27] Law on taxes and duties, supra note 28.

[28] K. Vogel, M.Engelschalk and M. Gorl, *Klaus Vogel on Double Taxation Conventions: A Commentary to the OECD, UN and US Model Conventions for the Avoidance of Double Taxation on Income and Capital: With Particular Reference to German Treaty Practice, 3rd ed.* (Kluwer Law International, 1997), p.286

[29] 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 final - 2018/073 (CNS). Available on: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2018%3A148%3AFIN . Accessed February 2, 2019.

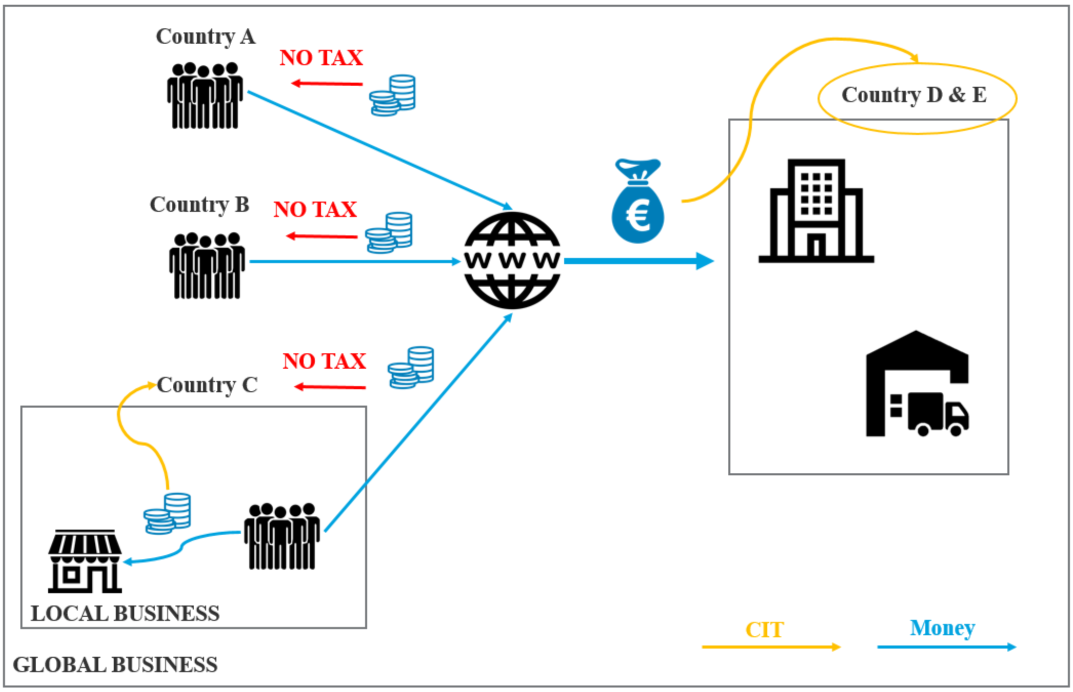

Table 3: A flow of collected CIT within a digitalized business model and brick and mortal business model [30]

As it can be seen in the table above, today business highly rely on intangible assets from which the problem within these thesis will mostly concern digital platforms from which these business generate a high share of their profits.[31] Because of the presence of these intangible elements, businesses does not require a physical presence in order to be able to operate within a MS. If the entity with a global business model would have a registered IP or would have a branch office within countries A, B or C, then part of the taxable revenues might be attributable to these countries, however as the example disclosed in the table above assumes that this company does not have any physical presence within these countries, then these countries end up with no tax despite the fact that the revenues originated from their territory. Thereby, as it can be seen in the table above, nowadays revenues from cross-border online transactions are being taxed in the country where the company itself is located, without determining PE by the place of customer.[32]

Overall, following the current taxation principles a company becomes subjected to a corporate tax if either it is incorporated within a specific country or if it has a PE located within its territory. Even if the company gains most of its revenues via digital means (without a physical presence), it will still be taxed within a country where it has a physical presence creating a PE or where it will be incorporated in.[33] Thereby, it can be concluded that the

[30] *Created by author, icons are obtained from the sources of internet.*
[31] Communication from the Commission to the European Parliament and the Council. A Fair and Efficient Tax System in the European Union for the Digital Single Market, COM/2017/0547 final. Available on: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52017DC0547 . Accessed on May 12, 2019.
[32] A. Bal, *The Sky's the Limit – Cloud-Based Services in an International Perspective*, 68 Bull. Intl. Taxn. 9, Journals (IBFD: 2014)
[33] Jaag L.U. Cavelti and C. Rohner, *Why Corporate Taxation Should Mean Source Taxation: A Response to the OECD's Actions against Base Erosion and Profit Shifting*, (International: Journals IBFD, 2017), p. 353.

taxation rules are not sufficient enough as nowadays digital businesses highly depend on the intellectual property that can be easily moved therefore making it possible to have a large-scale cross-border trade without having any physical presence.[34]

1.3. Amazon case

Question of whether taxes are paid and distributed between countries fairly has always been a global and contemporary issue- in the last decade there has been a public discussion regarding these questions. For example, in 2012 there were significant scandals concerning how Amazon is paying its taxes, in more detail- whether they are paying their fair share of taxes in a MS where they operate and therefore gain the revenues the most.

In 2012, Public Accounts Select Committee chaired by Margaret Hodge MP questioned Amazons Director of Public Policy during which many interesting aspects were raised. The focus consisted of the fact that Amazons EU headquarters are located in Luxembourg with its warehouses located all around the Europe- the UK was most concerned about the fact that majority of Amazons EU revenues were gained from the UK, however the UK did not receive corporate taxes deriving from these revenues.[35] Additionally, what made things worse was the fact that it seemed that Amazon mislead customers in thinking that there is a separate UK branch as the online address referred to amazon.uk, therefore in some levels making them believe that they are supporting a local entity that is paying taxes in the UK.[36]

Thereby, this example once more outlines that the tax was and still is applied irrespective of where the customers are located- it still looks at the location of a physical presence instead of looking for human presence. Additionally, while listening to the answers provided by Amazons Public Policy Director Andrew Cecil, it was possible to conclude that the company sees its business with the EU as a single EU Business or Pan-European business instead of treating each Member State as a separate Unit.[37] As Austin Mitchell outlined it in 2012, Amazon revenues in the UK stands to 1 228 million Pounds (around 1.4 billion euros) in 2010 alone, while gaining revenues in amount of 2.2 million in Luxembourg, however because of the location of a PE it ends up paying most of the CIT in Luxembourg.[38] The discussion on the topic could be seen especially crucial as by the end of a day Amazon was in a way dependent on the services deriving from taxpayers' money and because of the situation the local businesses were put out of business, as they were obliged to pay the standard business tax rates.[39]

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[34] OECD. *Addressing the Tax Challenges of the Digital economy, Action 1 -2015 Final Report,* OECD/G20 Base Erosion and Profit Shifting Project (Paris: OECD Publishing, 2015)

[35] Public Accounts Select Committee chaired by Margaret Hodge MP. Taxation of Multinational Corporations, available on: https://www.youtube.com/watch?v=21Xf8ADFvdc . Accessed April 3, 2019.

[36] Margaret Hodge MP, supra 35.

[37] Margaret Hodge MP, supra 35.

[38] Margaret Hodge MP, supra 35.

[39] Margaret Hodge MP, supra 35.

1.4. Concluding remarks

> The digital economy is a major opportunity for Europe and Europe is a huge source of revenues for digital firms. But this win-win situation raises legal and fiscal concerns.[40]

Today together with the new digitalized business model, there exist a possibility of business being located far away from consumers who are receiving these services. It can be noticed that the current taxation rules that are mainly focused of the assumption that the service provider and service receiver are located within the same country are no longer applicable. In order to justify where the value of business is actually created it is necessary to rebuild and adjust the rules of transfer pricing, PE and profit attribution for these digital technologies.[41] Moreover, it is highly significant to ensure that digital businesses are taxed fairly as later on this tax money will increase government's budget.

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[40]The European Banking Federation. Quote by Pierre Moscovici Commissioner for Economic and Financial Affairs, Taxation and Customs, Financial Services and Capital Markets Union, available on: https://www.ebf.eu/priorities/digitaltransformation/taxation-of-the-digital-economy/. Accessed April 20, 2019.

[41] Eric C.C.M. Kemmeren, "Should the Taxation of the Digital Economy Really Different?" in *EC Tax Review 2018-2. Editorial* (The Netherlands: Kluwer Law international, 2018), p. 72.

2. WHAT CHANGES WILL THE PROPOSALS FOR THE COUNCIL DIRECTIVES BRING?

The discussion of the global attention towards corporate taxation rules for digitalized business models (to be more specific, lack of rules attributable to these business models) has been around for a long time. Already in 2002, attention was bought to how the globalization and the appearance of electronic commerce could affect Value Added Taxes (hereinafter referred to as "VAT").[42] At time when discussing how the "ideal tax" would work, it was highlighted that this should follow the "destination principle"- thereby imports would be treated as domestic products and exports would not be taxed from whom they would be sold away.[43] Today, the EC is attempting to implement this idea by looking for a country where the customers are located rather than discussing where the entity itself is located. [44]

Currently there are no united rules governing how the CIT should be applied when dealing with income deriving from digital services. As a step towards acknowledging the problem of lack of instruments for a fair corporate taxation within the digitalized economy might be seen the Action Plan on Base Erosion and Profit Shifting[45] (hereinafter referred to as "BEPS") issued by the OECD on July 19, 2013.[46] It must be mentioned that the BEPS has seriously influenced the way in which international taxation is being coordinated, also in the EU level with multiple Directives in the area of CIT.[47] The very first action of the OECD Action plan stated as follows:

> "[1] Develop rules to allow countries to impose direct and indirect taxation on electronic commerce (the digital economy)."[48]

The OECD is not the only one who has outlined the necessity of an improvement in the sphere of taxation of the digitalized economy- also the EC has marked the Digital Single Market as one of its top 10 political priorities.[49] It has been acknowledged that this is not a problem that could be easily solved by countries alone- they should be solved collectively together thereby avoiding possible loop holes that might occur if the MS would try to create their own measures.[50]

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[42] Charles E. McLure, "EU and US Sales Taxes in the Digital Age: A Comparative Analysis" in *Bulletin for International Taxation* (IBFD: 2002), p. 135. Available on: https://research.ibfd.org/collections/bit/pdf/bifd040201.pdf. Accessed April 24, 2019.

[43] Ibid., p. 136. KPMG. VAT Newsletter. Hot topics and issues in indirect taxation, available on:

[44]KPMG. VAT Newsletter. Hot topics and issues in indirect taxation, available on: https://assets.kpmg/content/dam/kpmg/de/pdf/Themen/2018/vat-newsletter-january-february-2018-kpmg-en.pdf Accessed April 25, 2019.

[45] OECD. Action Plan on Base Erosion and Profit Shifting (OECD Publishing, 2013), available on: http://dx.doi.org/10.1787/9789264202719-en . Accessed March 30, 2019.

[46]Arnold, supra note 5, p. 202.

[47] Peter J.Wattel, Otto Marres and Hein Varmeulen, *European tax Law. Volume 1- General Topics and Direct Taxation. Student Edition* (Deventer:Wolter Kluwer, 2018), p. 242.

[48] Arnold, supra note 5, p. 202.

[49] Communication from the Commission to the European Parliament and the Council Exchanging and Protecting Personal Data in a Globalised World, COM/2017/07 final. (Brussels, 1 October, 2017)

[50]Commission staff working document executive summary of the impact assessment. Accompanying the document Proposal for a Directive of the European Parliament and of the Council reviewing the targets in Directives 2008/98/EC on waste, 94/62/EC on packaging and packaging waste, and

As a result, the EC has created two proposals for a Directive to create a unified treatment regarding digital tax- “Proposal for a COUNCIL DIRECTIVE on the common system of a digital services tax on revenues resulting from the provision of certain digital services”[51] (hereinafter referred to as “DST Directive”) and a “Proposal for a COUNCIL DIRECTIVE laying down rules relating to the corporate taxation of a significant digital presence[52] (hereinafter referred to as “SDP Directive”)”. [53]

As the fiscal market could be harmonized in the best possible way if global taxation rules would be implemented, the EC proposals have received a huge appreciation on international level.[54] The main concept of these directives is that profits will be taxed irrespective of the place of the establishment- they are planned to be taxed judging by the location of their consumers, thereby presumably solving the unfairness when distributing taxable revenues between MS.

To better understand what changes the EC has planned to introduce, the author will analyze both proposals for directives paying a special attention to such aspects as what revenues will constitute the tax base, what are the limitations (or when a company will become a taxable person) and lastly how the tax will be distributed within MS’s.

2.1. Analysis of the Short-term Solution: DST Directive

The first proposal included in the EC’s “package” meant for solving the issues arising from the changes in the business models caused by the digitalization of the economy is the DST Directive.[55] The DST Directive was published on March 21, 2018 and is currently planned to enter into force on the January 1, 2020, furthermore it outlines that the MS shall adopt it by December 31, 2019 the latest.[56] It must be noted that this Directive is meant as a quick fix before the SDP Directive is implemented. When the SDP Directive will be implemented, the DST Directive will no longer be applicable. Additionally, it he SDP Directive is adopted before the DST Directive, then the DST will not be adopted at all. However, it currently seems that the implementation of the SDP Directive will be lengthy, thereby it is at utmost importance to discuss the DST Directive.[57] The proposed DST Directive is supported by 20

1999/31/EC on the landfill of waste, amending Directives 2000/53/EC on end-of-life vehicles, 2006/66/EC on batteries and accumulators and waste batteries and accumulators, and 2012/19/EU on waste electrical and electronic equipment, SWD/2014/0208 final. (Brussels, October 1, 2017).

[51] DST Directive, supra note 29.
[52] Proposal for a COUNCIL DIRECTIVE laying down rules relating to the corporate taxation of a significant digital presence, COM/2018/0147 final - 2018/072 (CNS). Available on: https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A52018PC0147 . Accessed February 2, 2019.
[53] Supra note 6.
[54] Paolo Centore and Maria Theresa Sutich, ‘Taxation and Digital Economy: Europe is ready’ in *Intertax Issue 12* (IBFD: 2014), p. 785.
[55] Fred van Horzen and Andy van Esdonk, “European Union - Proposed 3% Digital Services Tax” in *International Transfer Pricing Journal, 2018 (Volume 25), No. 4* (May 2018), available on: https://research.ibfd.org/#/doc?url=/collections/itpj/html/itpj_2018_04_e2_1.html . Accessed May 2, 2019.
[56] DST Directive, supra note 29.
[57] Daniel Bunn, “A Summary of Criticisms of the EU Digital Tax”, *Tax foundation. Fiscal Fact* (October 2018). Available on: https://taxfoundation.org/eu-digital-tax-criticisms/ . Accessed May 13, 2019.

out of 21 national authorities and 53% of the public consultation respondents agreed that this might be a way how to solve the problem.[58].

The DST Directive outlines that the revenues acquired from “the monetization of the user input, not the user participation itself will be subjected to the DST at 3 percent rate.[59] Furthermore, as the main aim for this proposal the EC highlights the protection of the Single Market, ensuring that the tax is distributed fairly within Member States and fighting against aggressive tax planning and erasing possible loop-holes regarding taxation for digital companies.[60]

The DST Directive will be targeted at the business models for whom the user involvement is necessary to generate its revenues i.e. those business types that could not exist in their current form without having this user involvement. [61] For example, entities gaining their revenues from acting as intermediaries i.e. on a digital platform bringing customers and service (or product) providers together. Without user involvement, these entities would not be able to obtain revenues, as there would be no purpose of them. To continue, the DST Directive will implement the principle of profit allocation and how it should be attributed for taxation purposes between different jurisdictions and will determine what constitutes as value.[62]

First thing that all entities want to know before starting the compliance process regarding any time of tax is whether at all it will be considered as a taxable person, i.e., whether it will obliged to pay a tax deriving from its revenues. Thereby, the analysis of the DST will begin with establishing what will create a tax base and then will move towards defining the taxable persons themselves and the territorial scope of where the DST should be paid.

2.1.1. Digital activities obtaining revenues subjected to the DST

The DST Directive has established specific types of services that will create a taxable nexus for companies, however the Directive has also introduced some exceptions that could leave some entities without this additional tax burden, thereby in order to fully understand how the corporate taxation system will change the provisions regarding the tax base will be analyzed in more detail.

The EC characterizes the revenues falling under the scope of DST Directive as ones that require a user involvement in order to exist in their current form.[63] According to Article 3 of the DST Directive, the taxable revenue will consist of the following services:

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[58] Commission staff working document impact assessment. Executive Summary of the impact assessment. Accompanying the document Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence 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) 81 final} (Brussels, March 21, 2018). Available on: https://ec.europa.eu/taxation_customs/sites/taxation/files/fair_taxation_digital_economy_ia_summary_21032018_en.pdf. Accessed, February 17, 2019.

[59] DST Directive, supra note 29.

[60] DST Directive, Supra note 29.

[61] DST Directive, Supra note 29.

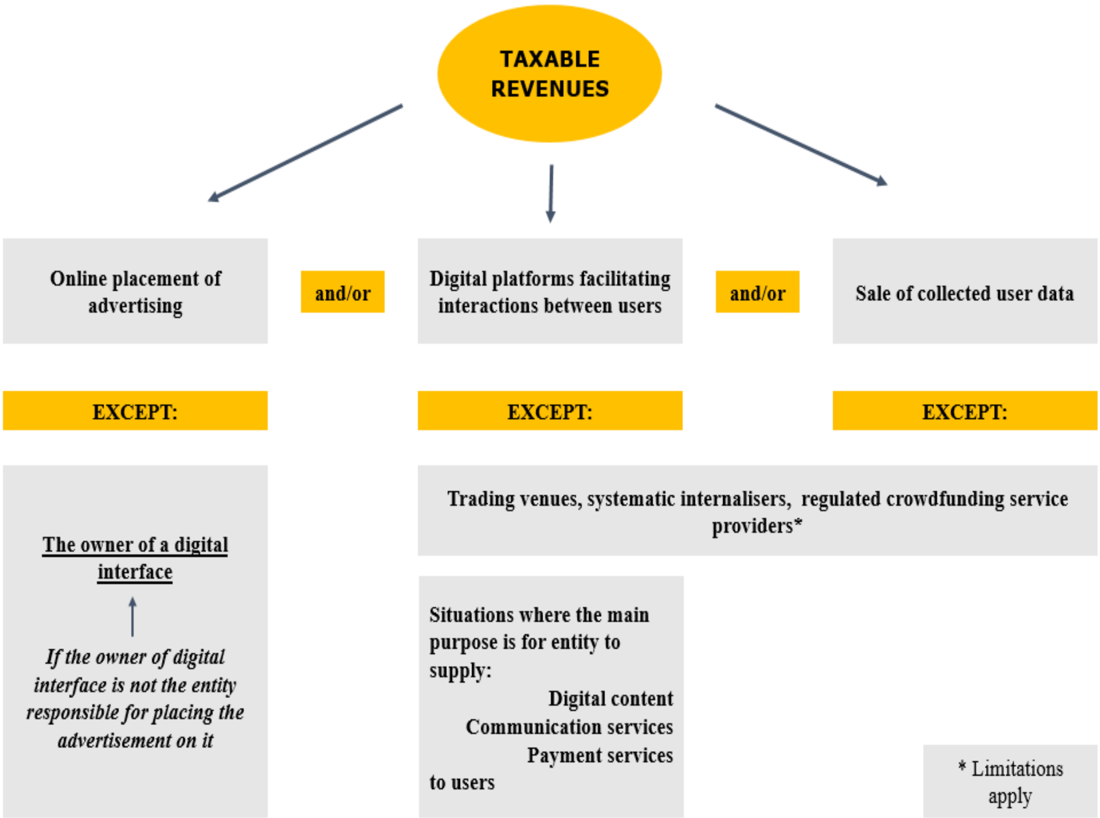
[62] DST Directive, Supra note 29.

[63] DST Directive, Supra note 29.

a) the placing on a digital interface of advertising targeted at users of that interface;

b) the making available to users of a multi-sided digital interface which allows users to find other users and to interact with them, and which may also facilitate the provision of underlying supplies of goods or services directly between users;

c) the transmission of data collected about users and generated from users' activities on digital interfaces.[64]



The forehead mentioned taxable services could be summarized as follows:

Table 4: Summary of taxable services under the DST Directive[65]

Article 3a of the DST Directive provides that the first type of taxable revenues are deriving from the **online placement of advertising** that can be frequently seen while being online. These are all advertisements that 'pop out' while doing some activities via digital platforms in form of web sites or apps. However, it must be remembered that the revenues deriving from entities placing the online advertisement will be subjected to the DST with an exception regarding situations where owner of the digital interface is not the one responsible for placing an advertisement on it has been created.[66]

For example, while using Google we can see advertisements promoting different kinds of services or goods. If there would be no user involvement, then Google would not be able to receive revenues regarding online advertisement as it presumably receives a certain fee for

[64] DST Directive, Supra note 29.
[65] *Made by author regarding the information received from:* DST Directive, Supra note 31.
[66] DST Directive, supra note 29, p. 8.

every users “click” on the advertisement in question.[67] However, this might be considered as a rent of digital space, thereby indicating that they may have already been taxed. In order to avoid double taxation the DST Directive establishes that responsible for DST will only be the entity responsible for placing the advertisement and not the owner of the digital platform as the EC considers that most likely the owner of the digital platform receives the revenues for the “rent” of digital space.[68] Accordingly, these revenues received by Google will not be treated as falling under the scope of “placement of online advertisements”. The revenues subjected to the DST will be one gained by the entity responsible for the placement of this advertisement.

However, despite the previous measures meant for avoidance of double taxation, some scholarly writers still believe that this situation may still arise, for example, if a sports team is being sponsored by another entity and this sports team publish advertisements of the sponsor in the teams web page (its digital platform), then the revenues generating from this online advertisement could create a tax base for the sports team under the DST Directive.[69]

To continue, under Article 3a taxable revenues are composed of **digital platforms facilitating interactions between users or intermediary services** that makes it possible for people and businesses to connect, thereby ensuring a communication with potential customers and a direct sale of goods or services.[70] These type of revenues rely on user’s participation on extensively high level as without users there would be nothing to “connect” or “bring together”. A good example of these types of services are such online platforms as Amazon or EBay as they ensure the possibility for sellers to connect with customers, thereby concluding business transactions.

There are three main “blocks” of the exceptions regarding revenues deriving from intermediary services. Firstly, as non-taxable services regarding DST will be treated the services whose main purpose is to ensure supply of digital content, communication and payment services.[71] These services have been left outside the taxable base since when providing these services they are more reliable of the development and sale of support software, rather than on user development.[72] Consequently, entities providing users with a possibility to communicate, for example, WhatsApp or Messenger, will not be regarded as generating revenues for DST purposes as well as e-banks and others ensuring payment services.

To continue, services excluded from the tax base will also be services concluded by an entity to users through digital interface consisting of such digital content as video, audio or text, because it is not completely clear where the value is created.[73] Knowing the fact that it is possible through a video to contact the supplier and purchase goods or services, the EC believes that in these circumstances this “intermediary element” is considered to be

[67] Bloomberg. Gerrit De Vynck and Mark Bergen on Google’s Ad Revenue Mystery: Five Possible Theories, available on: https://www.bloomberg.com/news/articles/2019-04-30/google-s-ad-revenue-mystery-five-possible-theories. Accessed May 10, 2019.
[68] DST Directive, supra note 29, p. 8.
[69] Nieminen, supra note 9, p. 668.
[70] DST Directive, Supra note 29, p.8.
[71] *Article 3 (4)(a) from* Supra note 29.
[72] DST Directive, Supra note 29, p.8.
[73] DST Directive, Supra note 29, p.8.

supplementary- the main purpose is to provide this digital content to a user.[74] Thereby even if through a video game there is a possibility to interact and conclude business transactions between two “players”, this video game will be outside the scope of DST.[75]

Last services excluded from the concept of intermediary services are payment services, thereby indicating that internet banks and other similar service provider will not be subjected to additional tax burden.

As it is stated in the Directive, services not generating taxable revenues are also concerned with trading venues, systematic internalizes and crowdfunding service providers.[76] To be more specific, services falling outside of the scope of DST will be ones related to services concerning decision making and transmission of financial instruments and operations of an organized trading facilities.[77] In addition, services that are granting loans will not be taken into account when determining the tax base.[78] These exceptions are created in order to avoid any interruptions within the environment for financial transactions that these services ensure.[79] If, for example, investment research services would have to face a new tax burden, then it would affect many other businesses and individuals relying on them. Additionally, the concept of value creation can be looked from the other way- understandably user involvement is highly important for these services, however bringing the buyers and sellers for these financial instruments together requires relatively more input by the entity itself than the user involvement does.

All in all, the DST Directive provides three large blocks constituting taxable revenues and it also provides rather clear list of explanations (see table below) , thereby at the present moment misunderstandings regarding the lawmakers intentions should not arise.

2.1.2. Taxable persons

It must be remembered that not all entities whose revenues derive from activities mentioned above automatically constitutes as taxable persons- according to Article 4 of DST Directive, an entity is treated as a taxable person if it falls under two criteria (see table below).

[74] DST Directive, Supra note 29, p.8.
[75] DST Directive, Supra note 29, p.8.
[76] *Article 3 from* Supra note 29.
[77] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU Text with EEA relevance, *OJ L 173, 12.6.2014, p. 349–496 (BG, ES, CS, DA, DE, ET, EL, EN, FR, HR, IT, LV, LT, HU, MT, NL, PL, PT, RO, SK, SL, FI, SV. 15.05.2014. Available on:* http://data.europa.eu/eli/dir/2014/65/oj. Accessed February 23, 2019.
[78] *Article 4 from* Supra note 29.
[79] DST Directive, Supra note 29, p. 8.

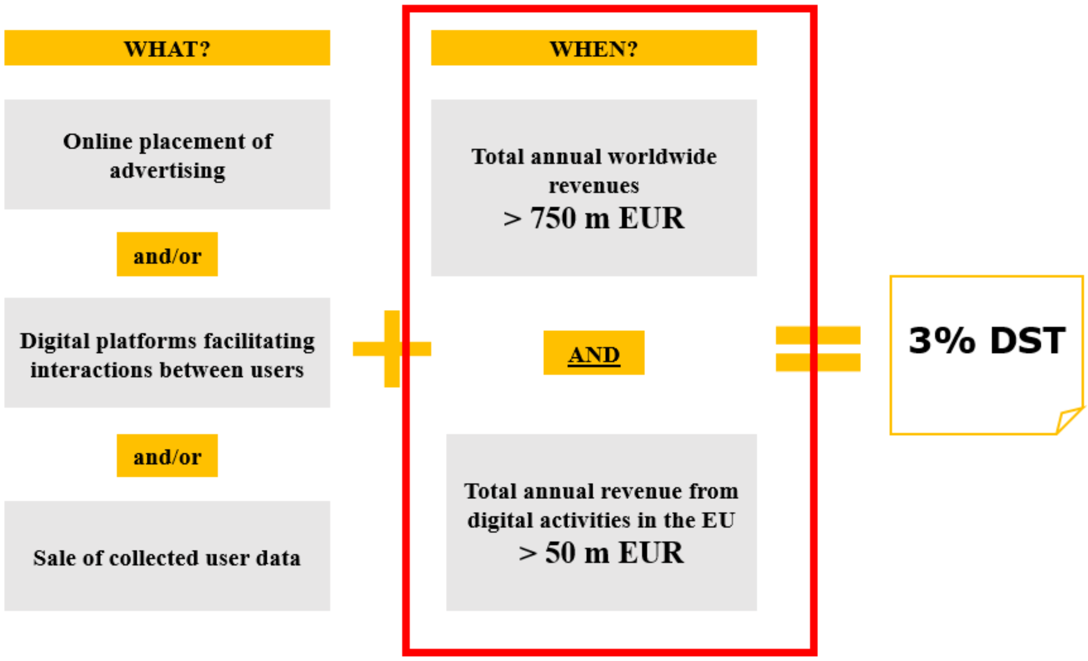


Table 5: Overview of the taxable persons including provision regarding taxable revenues[80]

First condition concerns the total worldwide revenues reported by the entity within a financial year that should be exceeding 750m EUR for a company to be considered as a taxable subject under the directive.[81] However the threshold set for the worldwide income is not the only one- the amount of revenues deriving from the EU will be measured as well, to be more specific, a company would be a subject to the DST if in addition to worldwide revenues exceeding 750m EUR its total taxable revenues obtained within the EU in a financial year would exceed 50m EUR.[82]

The EC explains that it specifically included these amounts of revenues to protect small businesses and SMEs while still taxing the big ones.[83] Therefore, if an entity does not exceed the threshold outlined in the article, then this entity does not have a burden to pay the DST. However, one might wonder whether such threshold would not stop small businesses from growing.

Thereby the previously highlighted issue related to taxable revenues when discussing a possible unfair treatment towards online advertisements that a sport team could publish in their web-page promoting their sponsors most likely would not rise significant issues, as presumably a sports-team would not achieve the taxable revenues of 50m euro.

To continue, mentioned thresholds would be checked on a yearly basis and will be based on the entities latest available financial statements before the end of a financial year.[84]

[80] *Made by author regarding the information received from:* DST Directive, Supra note 29.
[81] *Article 4 from* Supra note 31.
[82] *Article 4 from* Supra note 31.
[83] European Commission. Fair taxation of the digital economy, available on: https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2017-5253058_en. Accessed May 2, 2019.
[84] *Article 4 from* Supra note 31.

It has been outlined by the Tax Law lecturer from the University of Tampere M. Nieminen that this might create compliance problems for businesses who issue their financial statements on the last day of the calendar year as in such scenario this entity would have only ten working days to notify the relevant institutions of their duty to pay the DST and thirty days to pay the tax.[85]

Moreover, during the compliance process, it must be noticed that the wording for this relevant article when discussing the threshold of 750m EUR mentions "total amount of worldwide revenues", however in relation to the threshold of 50m EUR a "total amount of taxable revenues".[86] Therefore, when talking about worldwide revenues it can be assumed that the Article 4 is concerned about all the revenues deriving from the entity, however when discussing EU revenues- only the ones that create a taxable base.

That might make the process of compliance even more difficult- if for worldwide revenues companies should simply check the amount of total revenues included in the respective Financial Statement, then to get the size of EU's footprint they most likely would have to take into consideration the following steps. Firstly, they would have to separate EU revenues from worldwide profits (that might be challenging taking into account the nature of digital business) and secondly companies would have to split these EU revenues between ones that could be subjected to the DST (this would be the check-point for the threshold of 50m EUR) and the others.

All in all, there do exist some questionable aspects set by the thresholds within the DST Directive that might have an unfortunate affect towards MS and targeted entities (these issues will be analyzed within chapter 3).

2.1.3. Territorial scope

When an entity is being considered as taxable person and it has obtained revenues that under the DST Directive is considered being taxable, it is important to understand where exactly this tax should be paid. By now, it should be understood that the intention of the DST Directive was to ensure that an entity pays its fair share of tax within the country where the user is located.[87] However, the treatment of whether a user will be deemed to be located within a MS will differ depending of the taxable service type. This part of the thesis will describe when exactly a user will be considered as being located within a MS by describing the treatment of each service one by one.

If an entity has obtained revenues through **online advertisements** falling under the scope of tax base under DST Directive, then a user regarding these types of services will be treated as located within a specific MS if the advertisement in question will appear on users device while the device will be used within this MS.[88] It must be remembered that the location of a device will be verified by reference to the Internet Protocol (hereinafter referred to as "IP") address or any other method if it will be sufficient enough to determine the geolocation (this method will be used to determine the location of user's device throughout the DST Directive and SDP Directive. DST Directive).[89] It must be noted that this approach

[85] Nieminen , Supra note 9, p. 665.
[86] DST Directive, supra note 29.
[87] DST Directive, Supra note 29, p. 11.
[88] *Article 5(2)(a) from* Supra note 29.
[89] *Article 5(4)(a) from* Supra note 29.

gives a room for a user to be considered as being located within more than a one MS throughout the tax period. Additionally, this measure (as well as others discussed in this subpart) will only concern activities that occurred within taxation period- entities would not be obliged to examine what happened in the previous periods.

Furthermore, if within a tax period the online advertisements will be accessed in more than one MS, then the total revenues will be split proportionally to the number of users accessing this advertisement in each MS.[90] Thereby, if the online advertisement placed by an entity will be accessed by 10 thousand users in Latvia, 30 thousand users in France and 60 thousand users in Germany and if the total revenues will be 200 million euros, then 120 thousand will be attributable to Germany; 60 thousand- to France and 20 thousand- to Latvia.

To continue, if an entity receives taxable revenues through **intermediary services** a recognition of whether a user has been located within a MS in the tax period is determined by splitting them into two kinds of services. Firstly, a user is treated as being located within a specific MS if the user within this MS by accessing digital interface through its device concludes the supply of services or goods directly from the supplier.[91] Such measure is specified as, for example, when ordering food via digital platform the moment when user pays for the services provided by this platform presumably is the moment when the actual payment is made (a user looking at the possible food choices would not be enough).[92]

Second condition considers intermediary services not included in the previous point where a user has an active account on its devise through which he is permitted to access this digital interface and this account has been opened within the MS.[93] In the first situation a **proportion** attributable to a specific MS would be determined regarding the number of users who actually concluded a transaction while in the second it would be the number of users holding an account within the respective MS.[94] Furthermore, both situations do not take into consideration the location from which the payment toward the digital platform has been made (whether it was covered by service provider or service receiver)- the MS where activity will be considered to be concluded will always be the MS where a user is located.[95]

Lastly, if an entity obtains services through **sale of user data** a place where revenues should be taxed will be determined by the place where a device used by user to access digital interface was located.[96] It is important to understand that the moment that the moment when this data will be transferred will be taken into account irrespective of when this data was collected.[97] Thereby if a user has accessed the digital interface in previous taxation periods (and as a result an entity has collected its data in previous periods) and the data is being transferred within the taxation period, the moment of taxation will be the moment when data

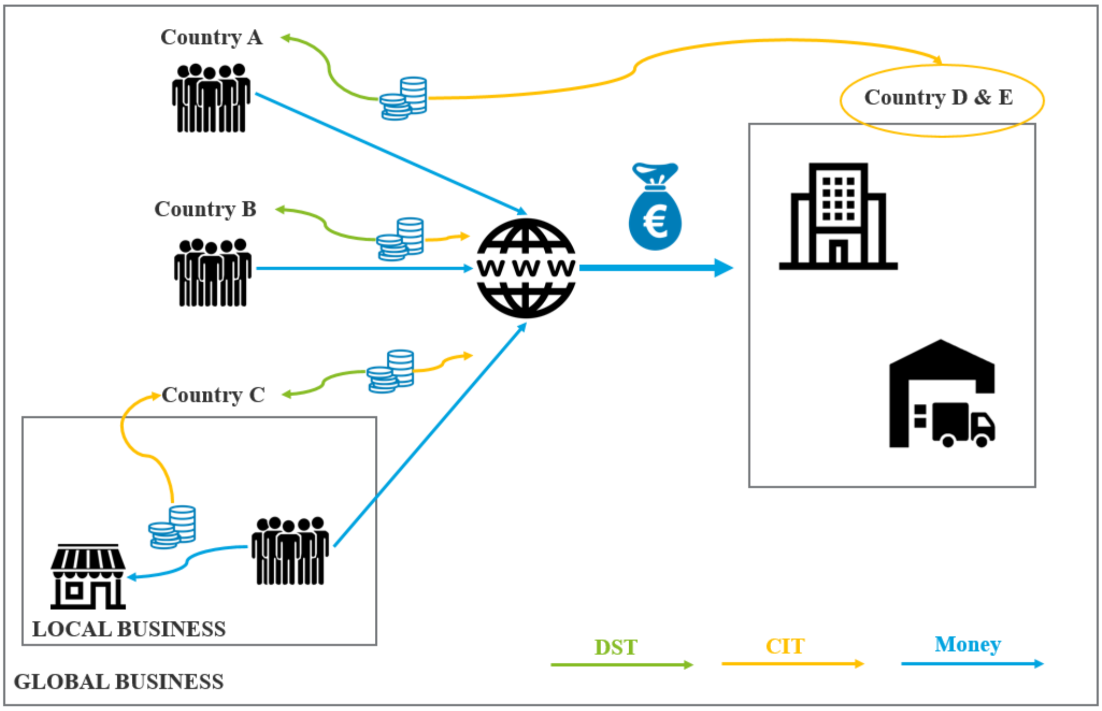
[90] *Article 5(3)(a) from* Supra note 29.
[91] *Article 5(2)(b)(i) from* Supra note 29.
[92] European Commission, Commission Staff Working Document, Impact Assessment, Accompanying the document Proposal for a council directive laying down rules relating to the corporate taxation of a significant digital presence and Proposal for a Council Directive on the common system of a digital services tax revenues resulting from the provision of certain digital services, SWD(2018) 81 final/ 2.p. (Brussels, 21.2.2018). available on: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018SC0082. Accessed May 1, 2019.
[93] *Article 5(2)(b) (ii) from* Supra note 29.
[94] *Article 5(2)(b) (ii) from* Supra note 29.
[95] Nieminen, supra note 9, p. 673.
[96] *Article 5(2) from* Supra note 31.
[97] *Article 5(2) from* Supra note 31.

is being transferred and not when it has been collected (as presumably at that point an entity would receive revenues regarding this transaction). Again, the proportion attributable to a MS will be concluded regarding the amount of users whose data was transferred within the taxation period.[98]

As a result, it can be concluded that throughout all types of digital services subjected to DST Directive, the place of taxation will always derive from the location of user or to be more specific- the place of user's device. The DST Directive will not consider the location of the supplier nor the location from where the revenues regarding these services derived.[99] Thereby, even in a situation where a consumer located in France concludes that the payment of goods consumed via digital platform will be provided from Germany to the supplier located in Latvia, the place of taxation will still be considered to be France as that will be the place where user access this digital platform.

2.1.4. Concluding remarks

To sum up, the DST Directive would work as a quick fix for the current issue of the unfair tax treatment caused by the digitalized economy; furthermore, the DST Directive could instantly generate tax revenues towards MS governments.[100] Taxable revenues under the DST Directive will be composed from the online advertising, transmission of user data and intermediary services, i.e., services that the EC believes are the main services where the value is being created by the users, furthermore the 3% DST would only be due for the entities who would be big enough to reach the thresholds set by the Directive. The outlook of how the Directive would look in the real life can be seen in the table below. As it can be noticed the DST Directive would successfully solve the issue of countries receiving their fair share.



[98] *Article 5(2) from* Supra note 31.
[99] DST Directive, supra note 29, p. 8.
[100] Nieminen, supra note 9, p. 673.

Table 6: What will change after the implementation of the DST Directive?[101]

2.2. The long term solution- SDP Directive

The second proposal included in the EC's "package" meant for solving the issues arising from the changes in the business models caused by the digitalization of the economy is the SDP Directive.[102] The SDP Directive was published on March 21, 2018 and is currently planned to enter into force on the January 1, 2020, furthermore it outlines that the MS shall adopt it by December 31, 2019 the latest.[103] The EC's plans to include this proposal within the Common Consolidated Corporate Tax Base[104] (hereinafter referred to as "CCCTB").[105] If this proposal successfully enter into force at the set deadline, then the previously discussed DST Directive will not enter into force at all, however as the implementation of the SDP Directive might be lengthy, then the DST Directive will be applicable until the SDP Directive gets implemented.[106]

As outlined in previous parts of the thesis, the main problem regarding corporate taxation arise because the current definition of a PE mostly focuses on where a company is physically present. Today an enterprise can have a significant presence in the country without falling under the requirements of a PE, for example, Facebook or Google has a significant presence in almost all of the EU MS and yet they do not constitute as having PE's within these MS and therefore they are not paying CIT in all of them. It must be outlined that the problem lies not within the fact that these companies are not paying some taxes, but within the fact that they are paying them only within a country where they are considered as being physically located in. Thereby, a CIT regarding revenues gained from all these MS is being paid in these "lucky" countries falling under the current definition of a PE (or where this company is incorporated in).

Thereby, to solve this problem the SDP Directive will re-create the definition of a PE by creating a "virtual permanent establishment" that will be located within a MS if it will be considered of carrying on activities with a significant digital presence (hereinafter referred to

[101]Created by author, icons are obtained from the sources of internet.
[102] Alessandro Simone Samari, "European Union - Digital Economy and Profit Allocation: The Application of the Profit Split Method to the Value Created by a "Significant Digital Presence"" in *International Transfer Pricing Journal, 2019 (Volume 26), No. 1* (European Union: IBFD, 2018), p.1. Available on: IBFD- Tax Research Platform. Accessed May 13, 2019.
[103] SDP Directive
[104] European Commission. Common Consolidated Corporate Tax Base (CCCTB), available on: https://ec.europa.eu/taxation_customs/business/company-tax/common-consolidated-corporate-tax-base-ccctb_en. Accessed April 30, 2019.
[105] Willem Neuvel, Sylvia de Jong and Agata Uceda, "European Union - Profit Attribution Challenges in a Digital Economy – A Transfer Pricing Analysis of the EU Virtual Permanent Establishment Concept" in *International Transfer Pricing Journal, 2018 (Volume 25), No. 5* (September 2018). Available on: https://research.ibfd.org/#/doc?url=/collections/itpj/html/itpj_2018_05_e2_1.html . Accessed on May 13, 2019.
[106] Daniel Bunn, "A Summary of Criticisms of the EU Digital Tax", *Tax foundation. Fiscal Fact* (October 2018). Available on: https://taxfoundation.org/eu-digital-tax-criticisms/ . Accessed May 13, 2019.

as “SDP”).[107] This idea has been supported by 14 out of 21 domestic tax authorities and 58% of the respondents of the public consultation have supported this solution.[108]

Thereby, in order to better understand how this long-term plan regarding taxing the digital businesses work and how they might differ from the provision in the DST Directive, the following sub-chapters will firstly the describe the concept behind the CCCTB and later on will analyze what requirements must be met for an entity to create a virtual PE within the MS and how the taxable revenues will be determined.

2.2.1. Overview of the CCCTB

On 2011, EC issued a proposal for a directive on a CCTB and later because of MS being unable to find a unanimity re-issued an updated version of the same proposal for a directive in 2016.[109] The re-launch was meant to ensure the ultimate solution in a fight for a fair erosion and profit shifting by global and multinational companies, therefore making this proposal quite political.[110] However, up until now the CCCTB still have not entered into force.[111]

CCCTB is meant to change the way of taxing cross-border companies by implementing a requirement to submit one tax return concerning EU activities and later offsetting losses in one MS against profits in another MS.[112] The proposal would apply for companies established under the laws of a MS if the company falls under criteria’s established in the Directive including such requirements as a revenue exceeding 750m EUR within a financial year and having a PE in another MS.[113] If implemented, the CCCTB would make life easier for companies having establishments in more than two Member States by giving them a possibility to calculate their taxable income by using one, common set of rules.[114] Therefore, companies should not be concerned about the different treatment within different legislations leading to an easier and less expensive tax compliance.

Currently if a multinational company has losses in Poland and profits in France, this company cannot “put them together”- by the end of a day, a company would have to submit one corporate income tax return for all participating MS instead of a CIT return for each specific MS. With a help of CCCTB it would however be possible to put them together in one tax return (MS would later distribute profits and apply their own CIT rates).[115]

It must be noted that it can be seen that the EC is treating CCCTB as if all MS would participate in it, however in the reality the CCCTB would be applicable only within MS who decide to implement it, therefore creating a possibility of division between MS with CCCTB and non-CCCTB Member States.[116] Moreover, implementation of CCCTB has been highly political, for example, in 2011 France and Germany were interested in creating a common

[107] Nieminem, supra note 11.
[108] Supra note 12.
[109] Wattel, supra note 12, pp. 429-431.
[110] Wattel, supra note 12, p. 484.
[111] Supra note 104.
[112]Supra note 104.
[113] *Panayi* , supra note 17, p. 81.
[114] *Panayi* , supra note 17, p. 81.
[115]Supra note 104.
[116] Supra note 17EU corp tax law 85

corporate tax base and tax rates[117], also EP has expressed its support towards the implementation of CCCTB.[118]

Currently, the EC has outlined that CCCTB would be the best possible solution in implementation of a fair and efficient corporate taxation system, although at the same time the EC admits that it currently would not work as a solution regarding issues in the taxation of digital businesses as the definition of a PE within the CCCTB is similar to the existing one and as it is applicable only within big multinational companies.[119]

The EC believes that implementing SDP Directive within the CCCTB could create a fair environment where companies acting within multiple countries could more easily deal with the tax burden. Author believes that this would be a great way how to structure the corporate taxation system, however the fact that the CCCTB has not been able to reach a consensus and enter into force might bring the question of whether the same will not happen to the SDP Directive.

2.2.2. What will determine the existence of a virtual PE within a MS- the analysis of a taxable person and the territorial scope

With the SDP Directive the EC has decided to follow the principles of the OECD BEPS Project[120] providing that the profits should be taxed at the place where the value itself if being created.[121] Thereby, the SDP Directive re-creates the concept of a PE by creating a virtual PE that will be located at the place where an entity has a SDP and where the value of the activities having SDP will be created. This part of thesis will describe the necessary components that entities must meet in order to establish a virtual PE within its territory. Additionally, it can be notice that the concept of a taxable person and the territorial scope define each other, thereby to make it more easier to understand, this part of thesis instead of discussing these concepts separately will look at them together.

To begin with, it is important to acknowledge the wide range of targeted persons that this Directive has set. If DST Directive indirectly created a situation where companies originating from non-EU countries could be treated as taxable persons (because they would exceed the limits), then the SDP directly states in its Article 2 that:

> This Directive applies to entities irrespective of where they are resident for corporate tax purposes, whether in a Member State or in a third country.[122]

However, it must be kept in mind at the very beginning of the discussion that in order to successfully implement new measures and safeguard that the taxation on the digitalization of the economy is fair, it is also important for MS to "upgrade" their Double Taxation Treaties

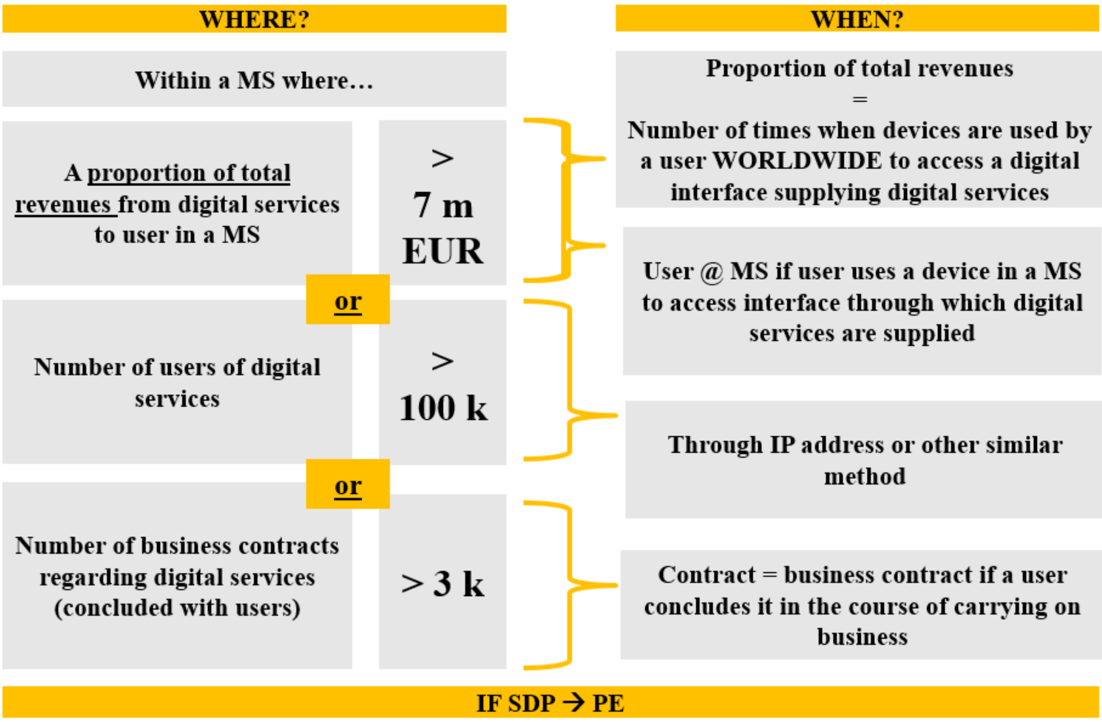
[117] Statement by President Barroso and Commissioner Rehn on proposolas by President Sarakozy and Chancellor Merkel, MEMo/11/557 (Brussels, 16 August 2011)
[118] Supra note 104.
[119] Supra note 52.
[120] OECD, *Explanatory Statement: OECD/G20 Base Erosion and Profit Shifting Project* para. 1 (OECD 2015).
[121] European Commission, Communication from the Commission to the European Parliament and the Council of Europe, A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action, COM(2015) 302 final, pp. 10-11 (17 June 2015), EU Law IBFD.
[122] *Article 2 from* Supra note 52.

(hereinafter referred to as “DTT”) with third countries.[123] This is an important step as if the EU Directive contradicts with the DTT, then the DTT has a higher power.[124] This aspect is discussed within the provisions of the Directive and they are as follows:

> […]in the case of entities that are resident for corporate tax purposes in a third country with which the particular Member State in question has a convention for the avoidance of double taxation, this Directive applies only if that convention includes provisions similar to Articles 4 and 5 of this Directive in relation to the third country and those provisions are in force.[125]

The “similarity” would be seen not as similarity in words but as similarity in the treatment and ideas[126], it still might be challenging to understand what constitutes as being ”similar” under this directive, as this concept gives a wide room for interpretation. For example, India is introducing a convention that presents a concept of a significant economic presence that might be treated as being “similar” to a concept of SDP.[127] Thereby if India includes such provisions in its DTT with MS then MS will have to determine whether these provisions would constitute as being somewhat similar to the concept of PE and profit attribution laid down by SDP Directive.[128]

According to Article 4 of SDP Directive, there are three situations when an entity would be deemed to have a virtual PE located within a MS thereby making it responsible for a tax payment within it. If for DST Directives purposes an entity had to fulfil all requirements to become a subject to tax, then in the SDP Directive it is enough if only one pre-requisite has been met. Additionally, if the DST Directive when identifying the taxable person will be responsible for a tax payment was concerned about worldwide revenues and the EU revenues, then the SDP Directive is mostly concerned about revenues deriving from each MS specifically.[129] The corner stone’s determining the place of taxation i.e. the place of a virtual



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127 Government of India, Memorandum Explaining the Provisions in The Finance Bill, available at www.indiabudget.gov.in/memo.asp . Accessed March 20, 2019.
128 Nieminen, supra note 9, p. 666.
129 Supra note 52.

PE, which would thereby make the entity as a taxable person, can be seen in the table below.

Table no.7: Components creating a PE under SDP Directive[130]

Firstly, an entity would have a burden to pay a tax on its revenues, if the mount of users located within a specific MS would exceed 100 000 and the amount would be determined through checking an IP address or similar method of geolocation.[131] A user would be treated as being located within a MS if the user would access a device in that MS in order to "access the digital interface through which the digital services are supplied".[132]

In Authors opinion, the biggest "enemies" for entities regarding this specific point would be all users who are travelling while still obtaining digital services. For example, a person could be accessing a digital services provided by Facebook via its mobile phone on daily basis. If this user would spend all tax period within one country, then he would be taken into account when calculating the threshold only within one country. However, if this person within the tax year would travel between ten MS and would continue accessing Facebook via its smartphone, then the users would be taken into account when calculating the threshold ten times. As this Directive does not provide any limits of in how many countries a user could be treated as being "located" within the specific tax period, then the user in the second scenario could be respected as being located within ten countries, therefore "filling up" entities threshold per MS ten times faster than the user in scenario one.

Secondly, an entity could become taxable in a specific MS if the taxable services obtained by users located in respective MS would create revenues whose total proportion regarding this MS would exceed 7m EUR.[133] To measure this threshold only revenues deriving from each MS would be takin into account separately. It would not matter how many revenues an entity collect in a global level, this threshold is only concerned about revenues deriving from each MS. Therefore, it can be noticed that similarly as with DST Directive, also SDP Directive will create a necessity for large entities to separate profits generated from each MS rather than sorting them in larger groups (for example, the EU or Baltic States or Central Europe countries etc.).[134] However, differently from DST Directive, SDP Directive finally creates a threshold regarding each MS separately.

Lastly**,** an entity will be responsible for tax payment within a specific country if it will have more than 3 000 "business contracts for supply of the digital services" concluded with users located in in the MS within the relevant tax.[135] While regarding first point (user using digital services), the user was deemed to be located within a MS by discussing whether the user obtained digital services from the territory of the respective MS, then in this point a user will be treated as located within a MS if in the specific tax period this user will be a resident for corporate tax purposes within the respective MS or if a user will be residing for corporate tax purposes in third country, however will have a PE in the respective MS.[136] Furthermore, a

[130] *Created by the Author including the information from* Supra note 52.
[131] Supra note 52.
[132] Supra note 52.
[133] Supra note 52.
[134] *For example, in the publically available Amazon's Annual Report it can be noticed that Amazon does not even show profits generated from EU separately from other parts of world.*
[135] Supra note 52.
[136] Supra note 52.

business contract would be a contract concluded between the user and service provider concluded while providing digital services.[137]

Assumptions of whether the SDP exist within a specific MS should be based on functional analysis by taking into account economically significant activities pursued through a digital interface and that are related to data or users.[138] It has been provided by the EC that most likely these services will emerge to ensure "development, enhancement, maintenance, protection and exploitation of the enterprise's intangibles".[139]

It can be concluded that the SDP Directive would re-create the way of how the revenues are attributable to the PE as because of the Directive revenues would be attributable to a PE depending on the fact where the user is located at the time of the transaction.[140]

2.2.3. Tax base

When determining what revenues will create a taxable nexus regarding the SDP Directive, entities will have to include a more precise interpretation of the Directive as under SDP Directive taxable revenues have a wider scope of the interpretation and they are not outlined as straightforward as they are under the DST Directive.[141] Tax base under SDP Directive will be composed of profits that will be regarded as having a SDP within the respective MS[142].

The SDP Directive in Article 5 provides that the tax base shall consist of the following services:

> (a) the collection, storage, processing, analysis, deployment and sale of user-level data;
>
> (b) the collection, storage, processing and display of user-generated content;
>
> (c) the sale of online advertising space;
>
> (d) the making available of third-party created content on a digital marketplace;
>
> (e) the supply of any digital service not listed in points (a) to (d).[143]

In order to ease the compliance process the EC has created Annexes to the SDP[144] providing a detailed list of services falling under the definition of digital services and a concrete list of services not falling under the scope of the Directive (as provided in the last sentence of the SDP Directive).[145]

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[137] Supra note 52.
[138] *Article 5 (3) from* Supra note 52.
[139] *Article 5 (4) from* Supra note 52.
[140] Arthur Cockfield, *Reforming the Permanent Establishment Principle Through a Quantitative Economic Presence Test* (Can. Bus. L. J., 2003), pp. 400-422.
Can. Bus L.J. *Reforming the Permanent Establishment Principle through a Quantitative Economic Presence Test*, 38 (2003), pp. 400-422
[141] Nieminen, supra note 9, p. 670.
[142] Supra note 52.
[143] Supra note 52.
[144] Annexes to the Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, {SWD(2018) 81 final} - {SWD(2018) 82 final}, available on: https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_significant_digital_presence_annex_21032018_en.pdf . Accessed May 11, 2019.
[145] Ibid.

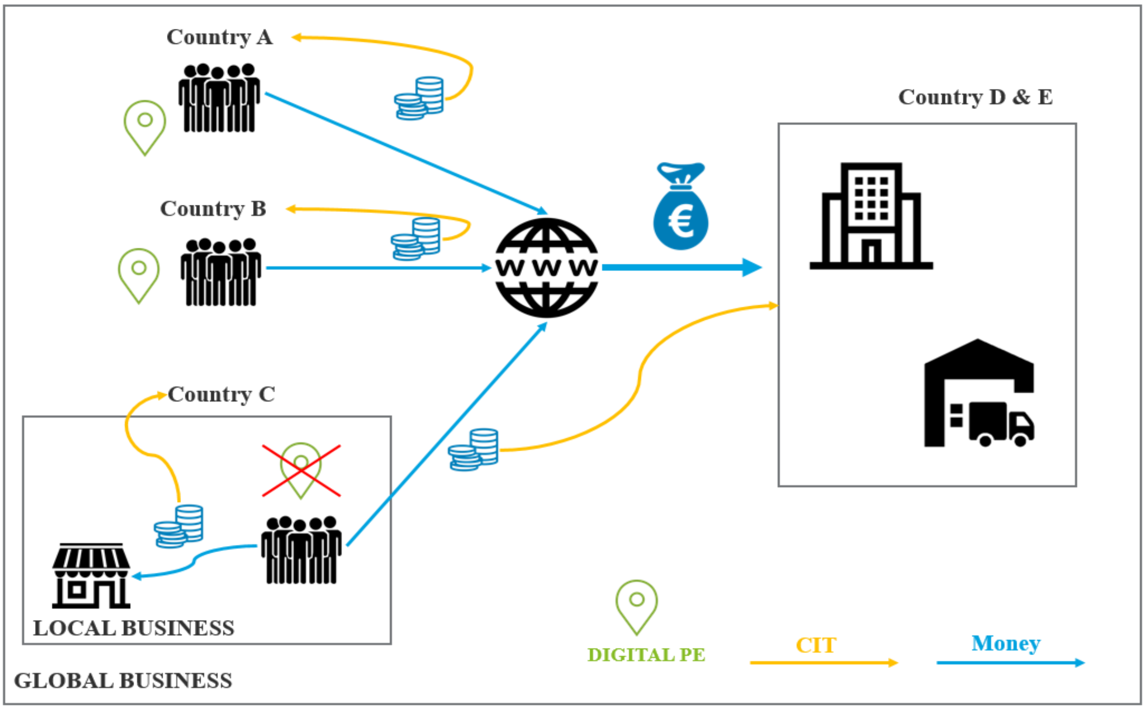
Additionally, it can be concluded that most likely SDP Directive will include in its taxable base all services that would simply constitute as "digital services" and that the guidance of the concept in question already exists within regulations regarding VAT.[146] The definition of these services is identical to one outlined in the Article 5(2) of SDP Directive:

> The profits attributable to or in respect of the significant digital presence shall be those that the digital presence would have earned if it had been a separate and independent enterprise performing the same or similar activities under the same or similar conditions, in particular in its dealings with other parts of the enterprise, taking into account the functions performed, assets used and risks assumed, through a digital interface.[147]

All in all, it has been concluded by the scholarly writers that the definition of the SDP under SDP Directive is intended to have a very similar scope as for the concept of "electronically supplied services" under VAT regulations.[148] Thereby it could be assumed that when creating this Directive EC was trying to create an environment where all taxes on the EU level are treated similarly. That would also ease the process of compliance for companies and make it less complicated for tax authorities to safeguard this compliance.

2.2.4. Concluding remarks

The long-term plan in the form of a proposed SDP Directive will significantly change the current corporate taxation system. The Directive will re-create the way in which the PE is determined by instead of looking at the place where an entity is physically present, but by discussing where this entity has a *significant digital presence.* Main aspect when determining whether an entity has a SDP within a MS takes into account the location of where the user is located and therefore the value is generated, thereby creating an environment where profits



[146] Supra note 4.
[147] *Article 5 (2) from* Supra note 52.
[148] Nieminen, supra note 9, p. 671.

are being distributed within countries fairly (see table below).

Table no.8: The changes of the CIT distribution after the SDP Directive gets implemented[149]

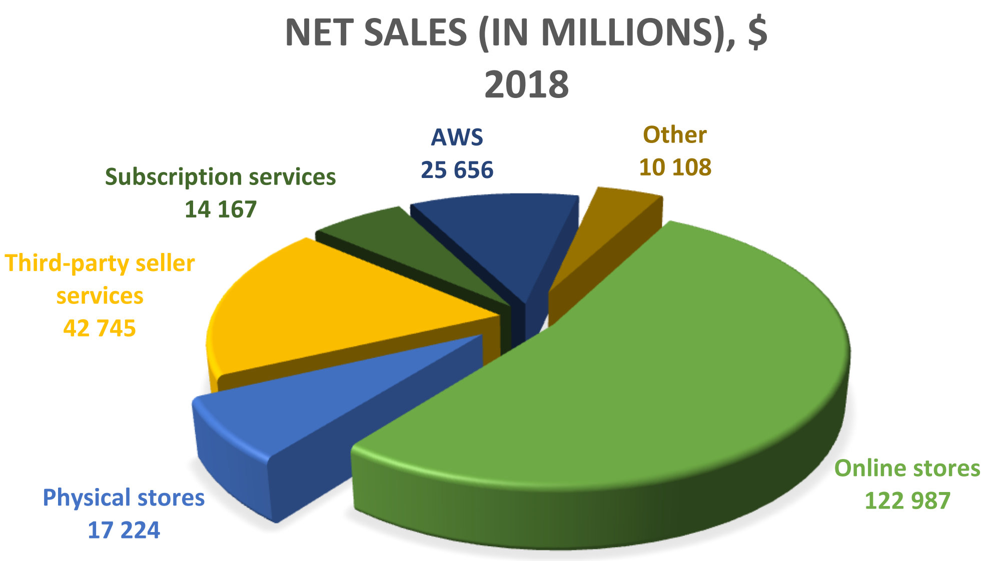
When comparing to the DST Directive, the SDP Directive has a wider scope of services that will be considered as being taxable, additionally if the DST Directive when determining the taxable person took into account the amounts of revenues received on EU or worldwide level, then the SDP Directive only focuses on the activities operated within one MS. However, taking into account the EC plans to implement the Directive within the CCCTB that so far has been proven to be unsuccessful rises a question regarding the future of DSP Directive.

2.3. Would revenues obtained by Amazon receive the same tax treatment under DST Directive and SDP Directive?

As it was possible to conclude after the analysis of DST Directive and SDP Directive, there exist differences of how the problem of the unfairness created by the outdated taxation system regarding digital businesses would be solved. However, as the author observed during the research process regarding the Directives, they are both planning to target similar services provided by the digital businesses. Thereby, in order to better understand whether there would be differences when complying with both directives, in the following sub-chapter the author will be analyzing how the revenues deriving from the largest tech company Amazon will be treated under both directives.[150]

Please be informed that this part of analysis will include many assumptions made by author as the publically available information does not provide all information necessary for a successful compliance process. However, it will be still possible to understand the differences in the tax treatment if they will occur.

Amazon’s Annual Report provides that in 2018 Amazon obtained its revenues from six types of services disclosed in the table below.



companies/list/#tab:rank. Accessed April 24, 2019.

Table no.9: Amazon's Net Sales split by the categories of services[151]

As it can be seen in table above, approximately half of obtained revenues derived from "**Online stores**" standing for product sales and digital media content sold (including the sale of digital product).[152] While it is hard to understand what exactly hides behind the "digital media content", it can be observed that "product sales" stand for product sold via Amazon's digital platform. Revenues from the transactions regarding online product sales under the DST Directive are considered as being outside of its scope as the created value lies with the provided products and the digital interference (Amazon) is simply being used for communication.[153] Thereby as far as it is possible to conclude from the information provided, these services will not generate taxable revenues under the DST Directive. The same treatment for online stores will be under SDP Directive as according to Annex III "goods, where the order and processing is done electronically" are not included in the tax base.[154] However, it must be noted that the fees received from ensuring the sale via online platform would be taxable under both directives (i.e. fees that sellers pay to Amazon for displaying their products to possible consumers).

AWS or Amazon Web Services are cloud services platform providing consumers with data processing and storage, low cost compute, databases and "tool managing".[155] AWS is mostly used by new companies and it helps them to work sufficiently by creating a platform or application meeting their needs.[156] These services will be considered as generating revenues regarding SDP Directive as they could be seen as "online data warehousing where specific data is stored and retrieved electronically" [157] underlined in the Annex II or they would create a taxable nexus by falling under the services outlined by the SDP Directive consisting of :

> services providing or supporting a business or personal presence on an electronic network such as a website or a webpage.[158]

However, it seems that revenues generated from AWS will not create taxable revenues for DST Directive as they are neither services for placing online advertisements, nor act as intermediary services, nor they are selling collected user data. Thereby, the treatment for these services is different between both Directives.

To continue, **subscription services** will be treated as taxable revenues under the SDP Directive and DST Directive as taxable services. It can be assumed that these services will be

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[151] *Made by author based on information obtained in* Amazon. Amazon.com announces first quarter sales up to 17% to $59.7 billion, available on: https://ir.aboutamazon.com/static-files/2a08aa1d-de2c-40e9-8d15-eb786be32b0e . Accessed April 6, 2019.

[152] Amazon. Amazon.com announces first quarter sales up to 17% to $59.7 billion, available on: https://ir.aboutamazon.com/static-files/2a08aa1d-de2c-40e9-8d15-eb786be32b0e . Accessed May 6, 2019.

[153] DST Directive, supra note 29, p. 8.

[154] Annexes to the Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, {SWD(2018) 81 final} - {SWD(2018) 82 final}, available on: https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_significant_digital_presence_annex_21032018_en.pdf . Accessed May 11, 2019.

[155] AWS, Cloud computing with AWS, available on: https://aws.amazon.com/what-is-aws/?nc2=h_ql_le. Accessed May 6, 2019.

[156] AWS, Cloud Products, available on: https://aws.amazon.com/products/ . Accessed May 11, 2019.

[157] Supra 154.

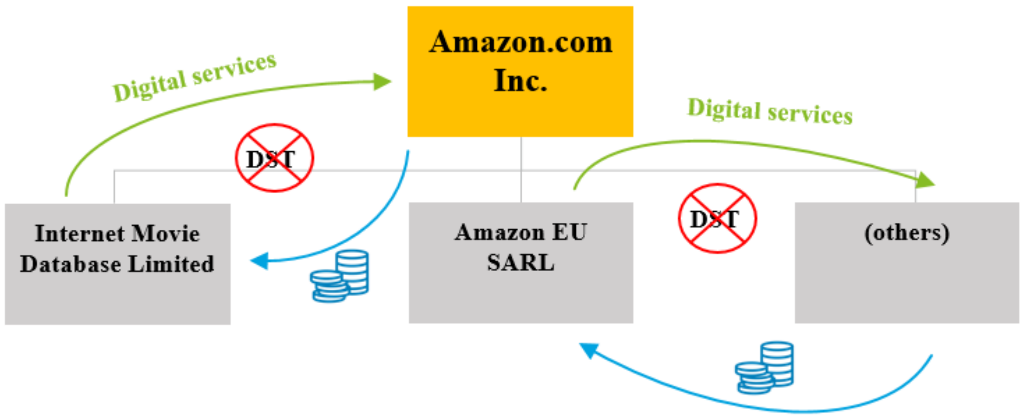
[158] *Article 3(5)(b) from* Supra note 52.

treated similar as **third party services** that as described by Amazon are "fulfillment, shipping[159] and other third party services".[160] These services can be considered as creating a taxable base as they require a user involvement and the value created indeed relays on users. These might be seen as revenues deriving from intermediary services, as with a subscription parties are able to participate in the process of bringing buyers and suppliers together(regarding DST Directive). Furthermore, under SDP Directive subscription services most likely will fall under the Article 3(5) stating:

> (d) the transfer for consideration of the right to put goods or services up for sale on an internet site operating as an online market on which potential buyers make their bids by an automated procedure and on which the parties are notified of a sale by electronic mail automatically generated from a computer.[161]

Physical stores will not be treated as generating taxable revenues under both Directives as they do not include a digital element and are working similar as existing brick and mortar business models. However, **other services** does seem like creating taxable revenues under both Directives as according to Amazon they" [p]primarily include sales of advertising services".[162] Thereby they might constitute as online advertisements from the DST Directive and SDP Directive.

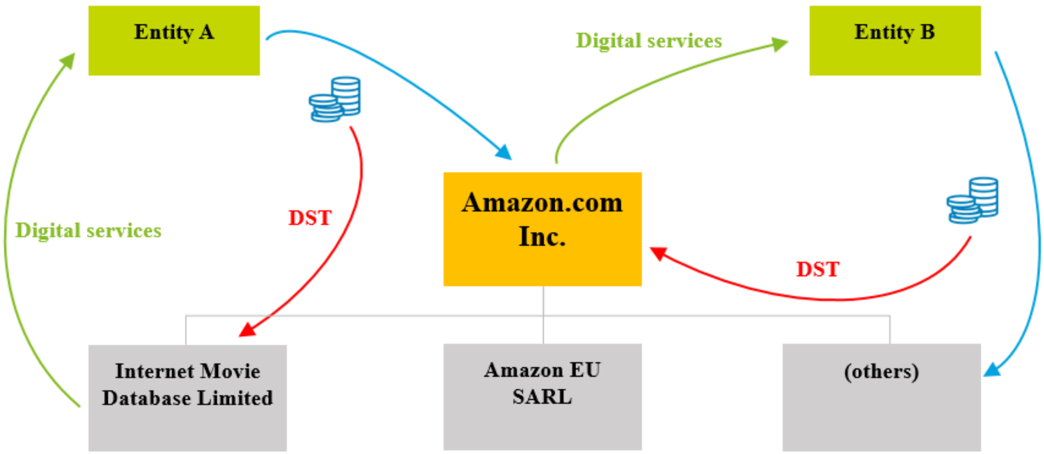
However, none of the revenues obtained from services above will create a taxable nexus under the DST Directive for Amazon if they will be concluded by entities who are part of its consolidated group for financial accounting purposes.[163] Thereby, if Amazon provides services that would normally fall under the scope of DST Directive to its daughter companies, then the revenues obtained would not be taxable.



[159] *If under "shipping services" are charged the actual costs of shipping, then these will not be treated as taxable revenues. However, as it would be impossible to exclude revenues for shipping services from "third party services", they will also be considered as generating taxable revenues. This should not affect the tax treatment analyzed by this part of thesis.*
[160] Amazon. Amazon.com announces first quarter sales up to 17% to $59.7 billion, available on: https://ir.aboutamazon.com/static-files/2a08aa1d-de2c-40e9-8d15-eb786be32b0e . Accessed May 6, 2019.
[161] Supra note 52.
[162] *Part of the "other services" most likely will not be generating taxable revenues, however to ease the process of analysis they will not be distributed.*
[163] DST Directive, supra note 29.

Table no.10: DST treatment within a consolidated group- Amazon case[164]

Additionally, if Amazon receives revenues from services that another group entity is providing to any third party, then these revenues under DST Directive will not create a tax



burden (regarding DST) for Amazon.[165] According to the DST Directive, these revenues will be taxable for the entity providing these services (see table below).[166] Thereby it must also be taken into account that if Amazon provides services to third parties, however revenues from these services are obtained by a different group company, then Amazon will be subject to DST.

Table no.11: DST treatment regarding transactions made from a consolidated group towards unrelated third party- Amazon case [167]

The SDP Directive does not provide any specifications regarding transaction within consolidated groups, however as the SDP Directive is planned to be included in the CCCTB, then there is a possibility that it will regulate them.

2.3.1. Concluding remarks

These analysis indicated that in order to successfully comply with the new CIT rules regarding digital services, Amazon (and similar companies) will have to carefully sort the revenues obtained in different categories, paying a special attention towards taxable services. Furthermore, as under both directives the threshold indicating whether an entity would be taxable or not requires the information of taxable services within the EU[168] or MS[169], then entities will have to acknowledge the taxable amounts in advance. While analyzing Amazon's Financial Report the author noticed that it does not provide any information regarding

[164] *Created by author based on the information from* supra note 29.
[165] DST Directive, supra note 29.
[166] DST Directive, supra note 29.
[167] Supra note 52.
[168] DST Directive, supra note 29.
[169] Supra note 52.

transactions deriving from the EU or its MS[170] that will be needed for the compliance process, thereby an additional compliance work will occur.

Overall, taking into the information disclosed by Amazon's Annual Report and following all the assumptions concluded, services treated as generating taxable revenues under the DST Directive will differ from taxable services under the SDP Directive. Additionally, when complying with DST Directive Amazon must pay attention to whom it is providing the digital services as if they are obtained within the consolidated group, then they will not create a taxable nexus. The SDP Directive bears a wider scope of taxable amounts than DST Directive, thereby, the DST Directive could give a good transaction period for entities before the SDP Directive gets implemented.

3. COMPARATIVE ANALYSIS OF THE POSSIBLE ISSUES DERIVING FROM THE DST DIRECTIVE AND SDP DIRECTIVE

It must be noted that the discussion of the DST Directive and SDP Directive proposed by the EC is not enough to fully understand how the corporate taxation system will look in the future as the future of these proposals for directives is rather unclear. Currently the European Parliament has approved the proposal for the DST Directive including their own amendments, however, the Council of the EU (hereinafter referred to as "the Council") has not been able to meet the final decision.[171] On April 14, the EP in its Plenary Session outlined that the possible reason for the failure to adopt the Directive lies within the lack of the political will from several MS to solve the problem (especially from the MS in which the tax havens have been created), thereby making it impossible to achieve the unanimity that is needed to successfully accept the directives.[172]

Moreover, the existence of the SDP Directive can also be questioned as it is deemed to be implemented within the CCCTB that has not been accepted since 2011 when it was first proposed by the EC.[173] As the need for directives structuring the corporate taxation system is urgent, there might be two possible outcomes from the situation: (1) either the SDP Directive will have the same destiny as the CCCTB in a form of lengthy struggles towards the implementation or (2) the SDP Directive will encourage the implementation process of the CCCTB.

However, as the need for a common set of rules governing the corporate taxation system is urgent, the author considers that the EU will manage to reach a common consensus and implement one of the directives (most likely the DST Directive will be implemented). The author acknowledges that there are slight changes made within the DST Directive, and that there are many more changes to come regarding both directives. These changes might be predicted with the analysis of the problems that both Directives might bear.

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[170] *It must be noted that the Financial Report did include net sales deriving from Germany and the UK, however it is still not enough to comply with the directives*

[171] European Parliament EPTV. Plenary session. Failure to adopt a EU digital services tax (debate), available on: http://www.europarl.europa.eu/ep-live/en/plenary/video?debate=1555358094938. Acessed on April 20, 2019.

[172] Ibid.

[173] Supra note 104.

Thereby, in this part of thesis author will analyze what kind of issues may arise from the SDP Directive and the DST Directive by discussing the possible problems from two perspectives: (1) from targeted businesses perspective and from the (2) MS governments perspective. Additionally, it must be noted that the compliance issues discussed within previous parts of thesis will not be further analyzed in this part.

3.1. Issues the DST and SDP Directives proposed by the EC might create from the targeted businesses perspective.

Three main aspects can be acknowledged when complying with the Directives- a possible breach of free movement of goods, problems regarding the provisions concerning data collection and complications toward entities who are part of a consolidated group.

The first issue that targeted entities might face derives from the thresholds set out by the DST Directive. To be more specific, the issue will be specifically concerned about the entities having **consolidated financial statements** for the entire group.[174] When determining the taxable person, the DST Directive looks at the consolidated financial statement for the whole group together.[175] If the EU threshold was concerned only about the taxable revenues, then the threshold for worldwide revenues constitutes of all revenues irrespective whether they are taxable or not.[176] Thereby if an entity obtains only taxable revenues in the amount of 50m EUR, then it would not be considered as a taxable person as it would not meet the threshold set for worldwide revenues. However, if this entity would be a part of a consolidated group for taxable purposes, then the amount for worldwide revenues would be measured by looking at the total amount of revenues obtained from the whole group together that most likely would exceed the threshold set by the DST Directive and thereby this entity would have a tax burden regarding these 50m EUR revenues deriving from taxable services. Thereby the DST Directive creates an unfair situation where only by having a consolidated financial statement entities would become subjected to the DST.

Secondly, the DST Directive and the SDP Directive might create a possible breach of **free movement of goods and services** protected by the TFEU.[177] The possible breach might derive from two aspects one of which only derives from the DST Directive while the other concerns both directives.

First aspect of the possible violation of free movement of goods and services lies within the thresholds set by the DST Directive regarding the determination of a taxable person (see table below).[178] The displayed situation creates an environment where local businesses can obtain taxable revenues at much larger scale within a MS without being subjected to a DST while global companies obtaining smaller amount of taxable revenues from the same MS would bear the tax burden. It was established in the *Säger* case that in order to ensure a free movement of services it is important to abolish any restrictions that might affect or

[174] Niemic, supra not1 9, p. 665.
[175] DST Directive, supra note 29.
[176] DST Directive, supra note 29.
[177] Supra note 12.
[178] Christina Dimitropoulou, “The digital services tax and fundamental freedoms: Apppraisal undr the doctrine of measures having equivalent to quantitative restrictions” in *Intertax Volume 47, issue 2* (the Netherlands: Kluwer Law International BV., 2019), pp. 201-218.

eliminate the activities of a service provider who provides similar activities in a MS.[179] Thereby, as in this example both entities are providing similar services, it can be assumed that when providing services within a MS the global company is being discriminated while discussing the tax treatment with the local entity, thereby giving a room for a discussion regarding the violation of free movement of services.

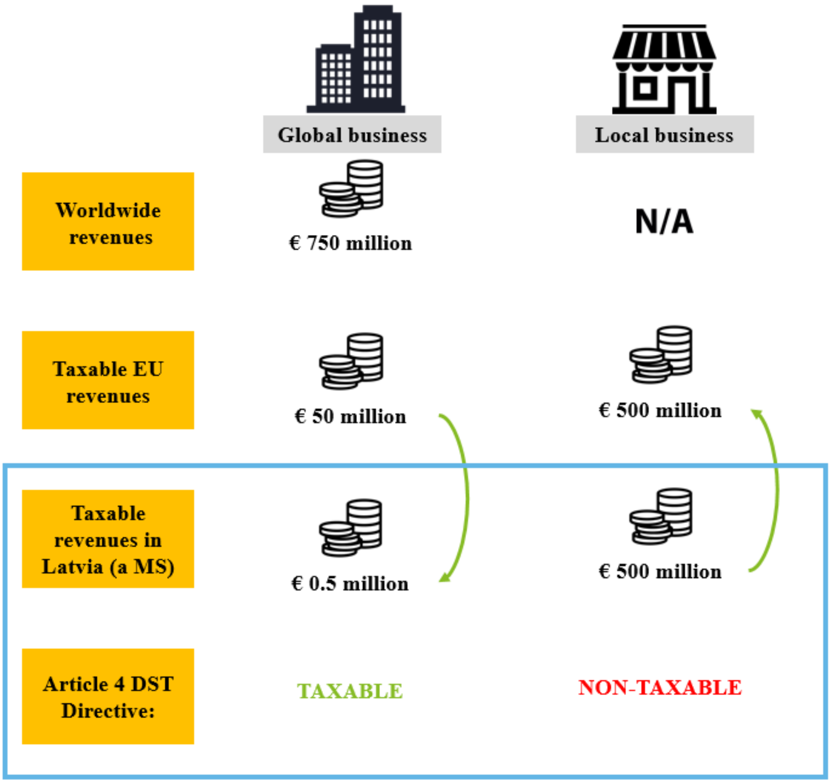

Table no.12: A comparison between tax treatment under the DST Directive for local and global businesses[180]

If the previously discussed problem will not derive from the SDP Directive as it discusses each MS separately (thereby in the given example a taxable nexus regarding taxable revenues would occur only for the global entity), then the second aspect of the possible violation of goods and services would derive from both directives.

Some scholarly writers believe that the taxable revenues deriving from the DST and SDP Directives can be seen as being ‘similar’ to the traditional services.[181] The scholarly writer calls upon a fact that the different treatment between similar services could be still seen as discoursing the free movement of goods. Furthermore, a case of *Commission v Belgium*[182] indicates that despite the fact that in this situation there is no direct discrimination, it still seems to exist regarding the indirect restriction to access the market for foreign goods because

[179] General court: Judgement in: *Manfred Säger v Dennemeyer & Co. Ltd. R,* C-76/90, ECLI:EU:C:1991:331, para. 12.
[180] *Created by the author based on infromation in* supra note 29.
[181] Christina Dimitropoulou, “The digital services tax and fundamental freedoms: Apppraisal undr the doctrine of measures having equivalent to quantitative restrictions” in *Intertax Volume 47, issue 2* (the Netherlands: Kluwer Law International BV., 2019), pp. 201-218.
[182] Court of justice: Judgment in *Commission v Belgium*, C-433/04, BE:ECJ.

of measures implemented by this directive.[183] Thereby, the Directives implement higher tax burden for entities simply because they are digitalized instead of being brick and mortal. The additional tax could make the accessibility of a market harder than for other- similar- non-digital businesses. Moreover, after *Cassis de Dijon*[184] case it was correspondingly established that different restrictions could influence consumer behavior.[185] Thereby, entities after the implementation of the proposed Directives could face restricted and more difficult accessibility towards these markets.

Lastly, the provisions regarding the **transmission of user data** could rise the following questions. Firstly, it has been questioned whether some activities falling under the concept of “data collection” will be taxed unfairly. As an example, so called “bug fixes” in phones when service provider collects user data to better understand and spot the issues and thereby be able to modify them accordingly.[186] Without such actions companies would not be able to provide a service in a good quality, furthermore customers are usually not being additionally charged for these modifications. Customers “paid” for these services already when purchasing a mobile phone or tablet.[187] To continue, a question regarding the transmission of the user data might make the concept of how companies will demonstrate how they are generating revenues unclear.[188] Taking into account that GDPR requires deletion of such user data or gives users a possibility to delete their data, rises a question of how the entities will manage to comply with it and what consequences such actions might bear.[189]

3.2. Issues deriving from the DST and SDP Directive regarding governments of the MS

Currently the interim measure- the DST Directive- has been supported by the EP (with adjustments), however as outlined by the EP in the Plenary Session the plan to implement these legal norms might be failed as the Council cannot reach the unanimous decision.[190] While the unwillingness to adapt the new rules might be seen as arising from the MS in whom the big tech giants have incorporated in (thereby bringing a huge amount of tax revenues into the MSs budget that after the implementation of the new Directives would be changed), then the inability for other MS to come up with a solution might be found unexpected. Furthermore, throughout the research it was possible to notice that the public discussion mostly focuses on problems regarding targeted entities leaving problems related to the MS themselves unexamined. Thereby, the author decided to analyze the problems that could possibly derive from the implementation of the Directives.

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[183] Ibid, para. 31 *(‘the disputed provision does make access to the Belgian market difficult for them’)*
[184] General court: Judgment in *Cassis de Dijon*, C 120/78, ECLI:EU:C:1979:42
[185] Dimitropoulou, Supra note 181, pp. 201-2018.
[186] TEI., TEI Comments on the European Comission’s Digital Economy Tax Proposals in *Tax executive September / October 2018* (the United Kingdom: Heinonline, 2018) , p. 69. Availabe on: Heinonline.Accessed April 30, 2019.
[187] Ibid.
[188] Ibid.
[189] Ibid.
[190] Supra note 117, *where the EP sugested the changing Councils voting sytem from the unanimity rule to the qualified majority vote*

There are three main blocks of issues that could be faced by the governments while implementing the SDP and DST Directives. All of these issues derive from the thresholds used by both Directives when determining the territorial scope and taxable persons.

First issue raised by author concerns the threshold provided by the DST Directive when determining taxable persons. This issue would affect all EU countries together. The problem lies within the amount of revenues allocated to the threshold of worldwide revenues and the EU revenues.[191] With the current limits set by the DST Directive a situation where an entity with significantly large amount of revenues is not being subjected to the DST while entity obtaining smaller amount of EU revenues would be considered as one (see table below). Thereby a supposedly unfair situation would be created in relation to the taxed revenues that the EU MS would have a possibility to collect.

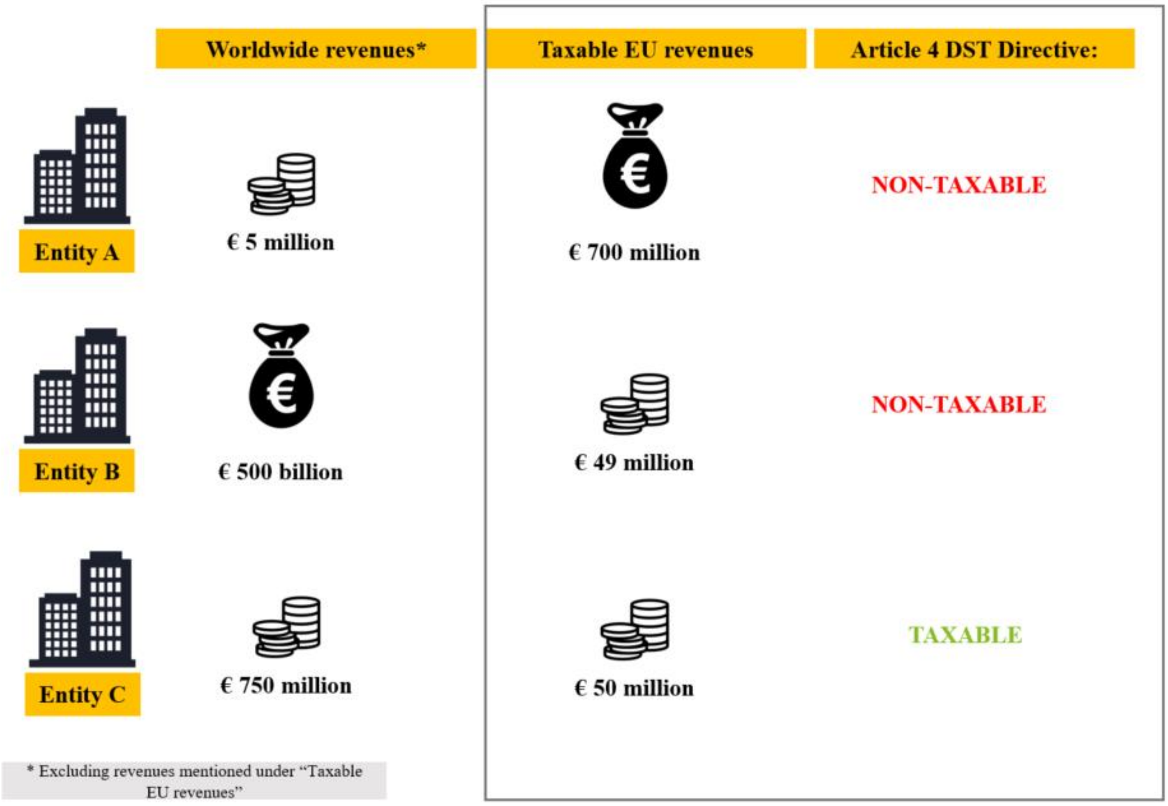


Table no.13: The DST Directive's treatment towards the revenues gained from different entities[192]

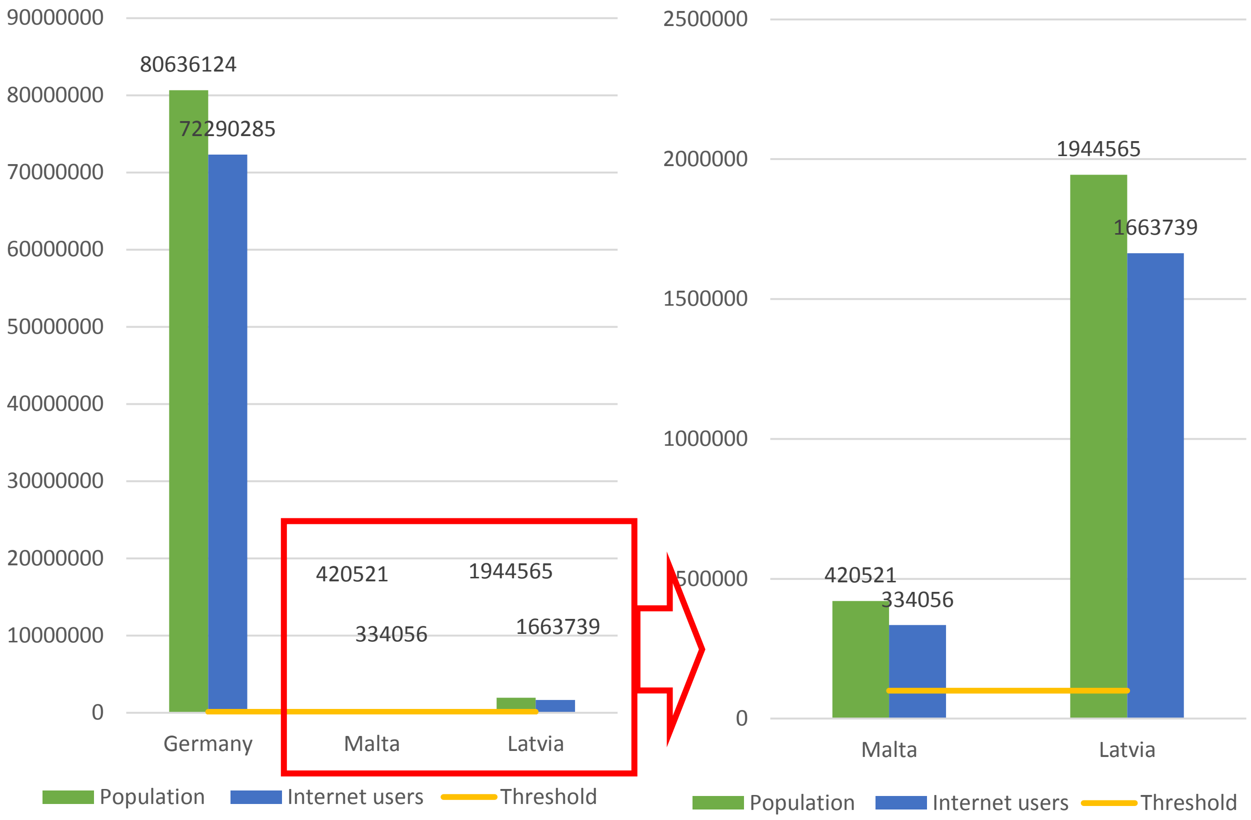
In the displayed situation, if we would look at the situation from the EU perspective, then we would expect that the entity paying the largest amount of taxes would be the entity A, however, according to Article 4 from DST Directive, the company A would not be subjected to the DST at all, as it does not have worldwide revenues exceeding 750m EUR.[193] At the same time company C and would be a subject to the DST as it falls within the thresholds set by DST Directive.[194]

[191] DST Directive, supra note 29.
[192] *Made by author based on the information provided by* DST Directive, supra note 29.
[193] DST Directive, supra note 29.
[194] DST Directive, supra note 29.

Furthermore, another aspect that author considers being interesting is the fact the EP has made amendment in the DST Directive by lowering the threshold for EU taxable revenues to 40m EUR.[195] Thereby if the Entity C in the example above would have earned 40m EUR in their EU taxable revenues, it would also be taxable, while the difference between the "EU footprint" for the Entity A and Entity C would only grow.

The thresholds set by the DST Directive are not the only ones rising questions as in authors opinion even more significant problems rise the thresholds set by the SDP Directive. Currently, all three thresholds set by the SDP Directive focus on each MS separately which, in authors opinion, is a very effective way as thereby it would avoid the problem of a possible breach regarding free movement of goods and services.

However, the EC has set these limits in the same amount within all MS, forgetting about the fact that these MS might significantly differ in their size. To better understand how that would affect governments chances of receiving tax payments from the digitalized businesses, an example indicating the differences between three MS has been displayed below. The table indicates the population, amount of internet users and the threshold regarding Germany, Malta and Latvia. These countries have been chosen to better show the difference- Germany being the largest, Malta- the smallest and Latvia- larger than Malta but



not reaching the size of Germany.

[195] 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), 13.12.2018., available on: http://www.europarl.europa.eu/doceo/document/TA-8-2018-0523_EN.html?redirect. Accessed May 15, 2019.

Table no.14: Comparison between the total amount of internet users and the population within Germany, Malta and Latvia[196]

It is rather confusing that the European Commission decided to create these limits based on an actual numbers rather than percentage. For example, as it can be seen in the table above, in June 30, 2017 the amount of internet users in Germany stood up to around 72 million while in Malta it was around 334 thousand and in Latvia- around 1.7 million users.[197] According to the SDP Directive, a company could become a subject to additional tax if amount of users within a MS exceed 100 thousand (the yellow line).

As a result, while in Germany it would take 0.14% of the total amount of internet users for company to become taxable within its territory, then it Malta it takes an impressive amount of 29.94% and in Latvia- 6.01% of internet users.[198] This leads to a fact that Germany can tax a company and therefore increase governments' expenditures when at least 0.14% of all internet users within Germany uses them. At the same time, it would take almost 30% for Malta to have a right to receive the taxes from these taxable services that are so crucial for a successful economic growth.

If the EC would have created a percentage of total internet users (or to make it easier to calculate- a percentage of the total population), then in author's opinion a more fair tax system would be created. As an example, in June 30, 2017, the population of all EU MS is around 506 billion (including the United Kingdom) from which around 434 billion citizens are internet users.[199] Currently, there are 28 MS, thereby the average amount of internet users per MS stands up to 15.5 billion citizens.[200] Therefore, deriving from the calculated average a company would need to provide its services to 0.65% of the average amount of internet users within the EU MS in order to become taxable. For Germany, these then would be around 467 thousand users, in Malta- around 2 thousand users and in Latvia- 11 thousand users. This measure would lead to additional compliance work for entities themselves, however in authors opinion this would also give a higher chance to collect the tax and to increase governments revenues not only for countries with a big population (for example, Germany), but also for ones with smaller population (for example, Malta).[201]

Moreover, the previously disclosed problem applies not only to the threshold regarding amount of users, but also to ones establishing the amount of business contracts and annual revenues needed for a company to be considered as a taxable person.

Lastly, the third problem regarding MS is concerned with the transition period from a DST Directive to the SDP Directive (if one will occur). DST Directive and SDP Directive both measure whether an entity will be taxable by implementing certain thresholds that when exceeded would indicate that the respective entity will be treated as a taxable person. However, while DST Directive focuses on the revenues deriving from the EU and on

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[196] Ibid.

[197] Internet World Stats. Internet Usage in the European Union, available on: https://www.internetworldstats.com/stats9.htm. Accessed on March 201, 2019.

[198] *Calculations made by author.*

[199] Internet World Stats. Internet Usage in the European Union, available on: https://www.internetworldstats.com/stats9.htm. Accessed on March 201, 2019.

[200] *Calculations made by author.*

[201] *Through this example, the Author is not implying that Malta and Latvia should be entitled to collect the same amount of tax revenues- in Authors opinion the problem occurs when these countries do not have a possibility to collect tax revenues from entities having a large business within their territory.*

worldwide revenues without looking at the MS separately, then the SDP Directive when indicating the taxable person is only concerned about each MS specifically without paying attention towards entities business activities on the EU or global level.[202]

Taxable under the DST Directive	DST DIRECTIVE	SDP DIRECTIVE
Member State A Taxable revenues: 40 m EUR	Taxable person	Taxable person
Member State B Taxable revenues: 6 m EUR	Taxable person	Taxable person
Member State C Taxable revenues: 4 m EUR	Taxable person	NOT a taxable person

From the table above it can be noticed that the situations will arise where through the transition from the DST Directive to SDP Directive some MS might loose tax revenues obtained from the entities that previously were considered as being taxable under DST Directive, however would not be treated as one in the respective MS when the SDP Directive is implemented.

3.3. Concluding remarks

If the Directives would be applied at their current look, multiple problems regarding targeted entities and the governments might arise. The most significant issues concerns the thresholds set by the EC and the possible violation of free movement of goods and services driving from the both Directives. As suggested by author, some issues related to the thresholds might be solved by applying a percentage rather than a fixed number, however the rest of the problems could not be solved in such an easy manner. Thereby the author predicts that the EU most likely will not accept these Directives in their current form without including any adjustments that could change the look of changes planned to be implemented within the current corporate taxation system.

[202] Supra note 29.

CONCLUSION

The purpose of this thesis was to create a better understanding of how the corporate taxation system would change after the implementation of the proposed Directives and to outline the issues that the Directives may create. Furthermore, as the Directive will not be implemented simultaneously i.e. either the interim solution in a form of DST Directive will be in force or the long-term plan in the form of SDP Directive will be applicable, the author analyzed the differences that the targeted person would face.

DST and SDP Directives will change the place of taxation moving it from the place where the targeted entity is established towards the place where the value is being created i.e. consumers are deemed to be located. If implemented, the DST Directive will introduce a brand new digital services tax in amount of 3%, while the SDP Directive would re-create the concept of a PE. However, despite the fact that both Directives have been implemented to fix the same issue that derives from the digitalization of the economy, the author did observe that the tax treatment between DST Directive and SDP Directive slight differ.

While the DST Directive when determining whether an entity is taxable examines the amount of the entities footprint regarding the obtained taxable revenues within the EU and their worldwide revenues, then the SDP Directive is only concerned about the business presence within a specific MS. To continue, when the DST Directive outlines only three services that will be ought as obtaining taxable revenues, then the SDP Directive provides a very wide definition of taxable persons. Lastly, the DST Directive when establishing the place of taxation looks at the place where services are being received i.e. if an entity is considered as a taxable person, the it will pay the DST in all countries it was deemed to have obtained these services proportionality. In the meantime, the SDP Directive will determine the place of taxation by looking at the place of the virtual PE i.e. the place where an entity has a significant digital presence.

However, during the research and analysis the author did came across many problems that might derive from the Directives if they would be implemented in their current form. While a possible violation of a free movement of goods and services has been raised regarding both directives, then the issues regarding the compliance process differs within the Directives. Furthermore, the author derive to a conclusion that these Directives could also create an unfair situation towards the MS governments and the targeted entities. This conclusion was rather unexpected as the purpose of the Directives is to fight the unfair treatment toward the MS.

The author does consider that the first Directive that the MS will have to implement within their taxation rules will be the DST Directive, as the concept regarding the implementation of the SDP Directive within the CCCTB seems to be as a very hard task to accomplish.

All in all as this topic is very fresh, there still do exist many issues and aspects of it that should be research further. The research should include the analysis of the final version of Directives accepted by the EU and should consult the opinions of the governments and the targeted companies themselves as they would provide an opinion based on the current situation and issues within this situation.

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