OPINION

European Economic and Social Committee

Digital taxation

Digital taxation
[exploratory opinion requested by the Czech presidency]

ECO/587

Rapporteur: **Benjamin RIZZO**
Co-rapporteur: **Petru Sorin DANDEA**

Referral	26/01/2022, letter from Mikuláš BEK, Minister for European Affairs
Legal basis	Article 304 of the Treaty on the Functioning of the European Union
Section responsible	Economic and Monetary Union and Economic and Social Cohesion
Adopted in section	01/07/2022
Adopted at plenary	13/07/2022
Plenary session No	571
Outcome of vote (for/against/abstentions)	200/0/1

1. Conclusions and recommendations

1.1 Developing adequate principles and rules on the taxation of the digital economy has become a fundamental task for both the European Union and other international regulators, in order to modernise fiscal policies and adapt them to current and future needs.

1.2 The EESC suggests that, once an international agreement is reached on Pillar 1 of the OECD/G20 Inclusive Framework regarding the reallocation of taxing rights, the corresponding rules are swiftly implemented in the EU in coordination and simultaneous initiative with other major trading partners.

1.3 The EESC deems that the EU can play a leading role with regard to the taxation of the digital economy. However, such a role should be played within an international agreement reached by the OECD/G20, as already happened for Pillar 2 with regard to the anti-base erosion mechanism.

1.4 The EESC deems it crucial for both Pillar 1 and Pillar 2 to be implemented within the EU as soon as it is feasible, achieving a high degree of consistency with the international agreement that will be negotiated within the OECD/G20 venue. Pillars 1 and 2 should be seen as a comprehensive and mutually integrated regulatory package.

1.5 The EESC notes that a European legislative initiative on taxing the digital economy could greatly benefit the internal market, undoubtedly resulting in a more efficient framework when compared with separate national initiatives. The introduction of uncoordinated and separate rules by the Member States would increase fragmentation across the EU, generating tax uncertainty and hindering competitiveness.

1.6 The EESC encourages an international agreement on Pillar 1 aimed at achieving an effective taxation system, respectful of the neutrality and equal treatment principles, as well as able to preserve the potential of innovation enshrined in the digital economy, on the one side, and to ensure that highly digitalised businesses contribute their fair share to national budgets, on the other side.

1.7 The EESC calls for an international agreement on Pillar 1 that refrains, as far as possible, from overly complex rules and is aimed at achieving transparency, predictability and administrative simplification, keeping compliance costs low. An overcomplicated system could indeed create opportunities to circumvent the newly agreed rules, reducing their effectiveness.

1.8 The EESC underlines that properly devised international tax laws on digital businesses are instrumental in preventing tax evasion and tax avoidance practices, as well as in designing a fair, stable and progressive taxation system. A level playing field in the area of corporate profit taxation is key since, in recent years, companies have been able to make use of specific tax rules in some Member States, substantially reducing their effective tax rate.

1.9 The EESC believes that a proper regulatory framework for taxing the digital economy should consider the heavy reliance on intangible assets brought about by digitalisation. These assets have greatly increased the ability of companies to develop relevant business activities in a jurisdiction without a physically presence there.

1.10 The EESC points out that digital businesses often exploits users' data to generate value. Such a method of generating value is not captured by current tax systems, producing a mismatch between value creation and taxation. This specific matter should be duly addressed within Pillar 1.

1.11 The EESC reiterates that it remains crucial to embrace an approach that will avoid the risks of double taxation, as well as unintended non-taxation in any jurisdiction, minimising compliance costs for European companies. In this respect, the agreement on Pillar 1 and the rules aimed at its transposition should harmonise the different initiatives already undertaken by Member States, avoiding discrepancies and loopholes.

1.12 The EESC sincerely hopes that a viable agreement on Pillar 1 might be achieved as soon as possible both at the international and the EU level, regretting the constraints still preventing the finalisation of such a fundamental agreement.

2. Essential context

2.1 The current international corporate tax rules are based on principles developed in the early 20th century and partially adapted over time. They are no longer fit for purpose in today's context and are not suited to a globalised and digitalised economy. This means that tax revenues are not being allocated to countries in a fair way and harmful tax practices are allowed to continue, to the detriment of public finances and fair competition.

2.2 Hence, developing adequate principles and rules on the taxation of the digital economy has become a fundamental task for both the European Union and other regulators around the world, in order to modernise fiscal policies and adapt them to current and future needs.

2.3 The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (IF) is built on a two-pillar solution to address the tax challenges arising from an increasingly digitalised and globalised economy.

2.4 Pillar 1 will aim to ensure a fairer distribution of profits and taxing rights among countries concerning the largest Multinational Enterprises (MNEs) and especially digital companies. Pillar 1 is mainly going to require multinational businesses to pay some of their income taxes where their consumers and users are located, creating a connection between profits and the places where the corresponding users and consumers are located.

2.5 The agreement to re-allocate profit under Pillar 1 includes the removal and standstill of Digital Services Taxes (DST) and other relevant, similar measures, bringing an end to trade tensions resulting from the instability of the international tax system.

2.6 Pillar 2 aims at ensuring that large multinationals, especially digitalised ones, pay a minimum effective corporate tax rate of 15 per cent, setting a regulatory framework that is able to discourage profit shifting and fit to prevent a detrimental tax competition among jurisdictions. Thus, a limitation on competition over corporate income tax might be effectively lifted, achieving a global minimum corporate tax rate, utilised by countries to protect their tax bases. The EESC urges all Member States to swiftly find a political agreement on these rules, regretting that a final consensus has not yet been achieved.

2.7 An international agreement on Pillar 2 and the inclusive Framework has been reached within the OECD/G20 forum and their transposition has been duly undertaken by the EU institutions via a Directive proposal, currently under discussion in the Council[1].

2.8 A shared international consensus in this respect is still being built within the OECD/G20, as confirmed by the recent OECD consultation on Pillar 1 which is collecting public feedback on the draft rules, even though such rules "do not reflect consensus regarding the substance of the document"[2].

2.9 The European Commission published a legislative proposal on the taxation of the digital economy back in 2018, which has not been pushed forward mainly due to the lack of an international, widely shared consensus on the rules to be implemented under Pillar 1.

2.10 In the meantime, the EU institutions have approved the Digital Markets Act (DMA) aimed at regulating the competitive structure of digital markets. In this respect, the EU has adopted an original and comprehensive regulatory approach, which differs from the ones embraced by other major trading blocks, such as the USA, China and other emerging countries.

2.11 The EESC deems that, following the example of the DMA, the EU can play a leading role also with regard to the taxation of the digital economy. However, such a role should be played within an international agreement reached by the OECD/G20, as already happened for Pillar 2.

3. General remarks

3.1 The EESC strongly believes that, in the context of the digitalisation of the economy, any change to the rules on the distribution of taxation rights on profits among countries must be coordinated globally in order to better harness the benefits of globalisation, with proper and effective global governance and rules. The concrete solutions devised must therefore be the consequence of a broad international agreement including as many tax jurisdictions as possible. Besides, the different impacts and implications of the new rules on small Member States, on the one hand, and bigger Member States, on the other hand, should be duly considered.

3.2 The EESC appreciates the significant evolution of the economy triggered by digitalisation and its positive effects on our society, as well as the great potential of digitalisation in empowering tax administrations, serving as a tool to deliver better services to national budgets and citizens. The EU will be required to help and coordinate the tax authorities of Member States to cope with the new regime and a fast-changing economic context.

1 See the EESC opinion *Minimum effective taxation of companies*, not yet published.

2 OECD Consultation on the Draft Rules for Nexus and Revenues Sourcing Under Pillar 1 – Amount A, 4 February 2022.

3.3 The EESC agrees with the finding of the OECD/G20 base erosion and profit shifting (BEPS) Action 1 - 2015 Final Report, observing that the digital economy is increasingly becoming the "economy itself". The digitalisation of many businesses over the years has been impressive and this process sped up during the recent COVID-19 lockdowns. Such a tendency often triggers a separation between the vast profits earned by digital platforms and the physical places where the related paying users and consumers are located. In the future, this phenomenon might also be addressed with regard to social security obligations.

3.4 Once an international agreement is reached on Pillar 1 of the OECD/G20 Inclusive Framework, striking a balance between the several positions expressed so far, the EESC suggests that Pillar 1 – just like Pillar 2 previously – may also be swiftly implemented in the EU, in coordination with other major trading partners, thereby consolidating the internal market in line with Articles 113-115 of the Treaty.

3.5 The EESC deems it crucial for both Pillar 1 and Pillar 2 to be implemented within the EU as soon as it is feasible and with a high degree of consistency with the international agreement negotiated within the OECD/G20 venue. Pillars 1 and 2 should be seen as a comprehensive and mutually integrated regulatory package to be swiftly deployed across the EU.

3.6 The EESC notes that a European legislative initiative on taxing the digital economy could greatly benefit the internal market, undoubtedly resulting in a more efficient framework when compared with separate national initiatives. The introduction of uncoordinated and separate rules by the Member States, following different taxation principles and criteria, would increase fragmentation across the EU, generating tax uncertainty and hindering competitiveness. The EESC encourages a dispute resolution mechanism aimed at allowing Member States to solve issues that might arise.

3.7 The international agreement on Pillar 1 should be aimed at achieving an effective taxation system, respectful of the neutrality and equal treatment principles able to: (i) preserve the potential of innovation enshrined in the digital economy, on the one side; and on the other side (ii) ensure that highly digitalised businesses contribute their fair share to national budgets and society.

3.8 The EESC calls for an international agreement on Pillar 1 that refrains, as far as possible, from overly complex rules and is aimed at achieving transparency, predictability and administrative simplification, keeping compliance costs low. An overcomplicated system could indeed create opportunities to circumvent the newly agreed rules, reducing their effectiveness.

3.9 The EESC underlines that properly devised international tax laws on digital businesses are functional in preventing tax evasion and tax avoidance practices, as well as in designing a fair, progressive, stable and efficient tax system.

3.10 The EESC underlines that Pillar 2, in turn, will effectively introduce the two domestic rules to be imposed, and more specifically:

A. interlocking domestic rules (Global Anti-Base Erosion Rules) featuring: (i) an Income Inclusion Rule (IIR), which imposes a top-up tax on a parent entity in respect of the low taxed income of a constituent entity; (ii) an Undertaxed Payment Rule (UTPR), which denies deductions or requires an equivalent adjustment to the extent that the low tax income of a constituent entity is not subject to tax under an IIR;

B. a treaty-based rule (the Subject to Tax Rule (STTR)) that allows source jurisdictions to impose limited source taxation on certain related party payments subject to tax below a minimum rate.

4. Specific remarks

4.1 The EESC highlights that a level playing field in the area of corporate profit taxation is key. In recent years, some companies have been able to make use of specific tax rules in some Member States, reducing their effective tax rate. A lack of transparency has contributed to such an outcome and several sensitive cases have involved multinationals active in the area of digital services.

4.2 The EESC believes that a proper regulatory framework for taxing the digital economy should consider the heavy reliance on intangible assets brought about by digitalisation. These assets have greatly increased the ability of companies to develop significant business activities in a jurisdiction without being physically present there. The current international tax rules and principles should be adapted to this new economic context.

4.3 The EESC points out that digital businesses are heavily reliant on intangible assets for content creation, in particular using and exploiting users' data to generate value. This method of generating value is not captured by current tax systems, producing a mismatch between value creation and taxation. This specific matter should be duly addressed within Pillar 1.

4.4 The EESC reiterates that it is of paramount importance to embrace an approach that will avoid the risks of double taxation, as well as unintended non-taxation in any jurisdiction, and will minimise compliance costs for European companies. In this respect, the agreement on Pillar 1 and the rules aimed at its transposition should harmonise the different initiatives already undertaken by Member States as these differences could trigger discrepancies and loopholes.

4.5 The EESC recalls that one of the key factors sustaining and motivating the complex attempt to achieve a global consensus on the OECD's Pillar 1 proposal is the proliferation of unilateral digital taxes and the connected potential for multiple jurisdictions to claim taxing rights in a variety of different and sometimes overlapping ways over the same profits.

4.6 Therefore, Pillar 1 should guarantee the removal of national digital service taxes and other similar measures on companies. That is crucial to ensure the consensus of several major jurisdictions on Pillar 1 and to avoid the new rules that might, in the future, be challenged as "discriminatory" under World Trade Organization (WTO) rules, with unintended consequences from an international trade perspective.

4.7 The EESC sincerely hopes that a viable international agreement on Pillar 1 might be achieved as soon as possible and regrets the enduring constraints which are preventing the finalisation of such an agreement.

4.8 The EESC deems that, once Pillars 1 and 2 are implemented, services provided through platforms used by European consumers should be fully incorporated in the VAT system, as an essential component in addressing the tax issues concerning the digital economy. It should be noted that digital communication services and social network customers access these services at no apparent charge, which raises the question as to how VAT could reasonably be applied. VAT revenues represent an own resource in the EU budget and the EESC considers it important to also include digital services in the tax base.

4.9 The EESC considers it necessary to strike a reasonable balance between the re-allocation of corporate profit taxes among net-exporting countries and net-importing countries, as well as among producers' and consumers' countries, so as not to jeopardise the possibility of countries to meet, amongst others, their social and environmental objectives.

4.10 The EESC notes that digitalisation is not only challenging, but also creates opportunities for tax authorities. Large amounts of third-party data available to tax authorities allow more reporting to be automated, saving both sides time and money. Data collection can also be used to tackle underreporting, evasion or fraud. The software solutions used by several tax administrations to record sales data at the time of a transaction – and can be submitted directly to tax authorities – have already increased some countries' VAT revenues significantly.

4.11 Lastly, for further and more detailed insights into specific matters, the EESC draws attention to its *Anti-money Laundering Legislative Package* opinion[3], as well as to both its opinions concerning the fight against tax avoidance: *Business Taxation for the 21st Century*[4] and *Fight the use of shell entities*[5].

Brussels, 13 July 2022

Christa Schweng
The president of the European Economic and Social Committee

____

3 EESC opinion on *Anti-money Laundering Legislative Package*, OJ C 152, 6.4.2022, p. 89.

4 EESC opinion on *Business Taxation for the 21st Century*, not yet published.

5 EESC opinion on *Fight the use of shell entities*, not yet published.