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Taxing the digital economy. An analysis of the OECD policies and the unilateral actions of national governments.

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A mio fratello Giovanni, la mia forza e motivazione più grande.

A mia mamma.

A mio padre.

Ai miei amici.

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INTRODUCTION

Globalization and the advent of new technologies have greatly changed the structure and business models of companies.

The progressive affirmation of the "Digital Economy", meaning for such both those attributable to e-commerce phenomena (direct or indirect) that of real services provided on the network, has given rise to difficulties growing both for traders and for general tax law theory[1].

The rapid expansion of the digital economy in all sectors of commerce and in the various phases in which the production chains are articulated requires to check whether traditional tax systems are still suitable for effectively frame the taxation of new forms of business and the products related to these. It is well known that the globalization of the market has led companies to change their production structures, to improve their competitive capacity and reduce the costs of management, including fiscal management, taking into account the particular importance assumed by the technological development and the diffusion of new types of intangible assets.

In particular, it should be noted that the absence of a physical link between the intangible assets that generate value (think, for example, of the intellectual properties that allow managing e-commerce sites, engines research or social networks of planetary importance) and consumer markets (of goods, advertising messages, etc.) make it more complex to associate the taxation at the place where the profits are made, with consequent increase the risks of tax avoidance or transfer of profits to countries low or no taxation.

The need to determine rules for the taxation of the digital economy has raised, therefore, the problem of the division of the tax base of a company between different national systems.

The international authorities have felt, in recent years, the need to intervene to achieve the so-called "fair taxation of the digital economy". At the request of the G20, the OECD began to analyse the problem in 2013 with the "*Base Erosion and Profit*

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[1] Fregni M. C., *Mercato unico digitale e tassazione: misure attuali e progetti di riforma*, in *Riv. dir. fin. sc. fin.*, 2017, I, p. 51.

Shifting (BEPS)" Project: it is a plan of 15 actions to tackle the problem of taxation of the digital economy globally and sets deadlines for the implementation of these actions.
The European Union has also examined the problem, giving rise, between 2014 and 2018, to several Communications and Proposals for Directives, analysed in detail below. However, the approval of these proposals seems rather remote: among the Member States, some have already expressed their opposition several times and very explicitly; others, however, prefer to wait for the final solution that will be proposed by the OECD, by 2020, unless further postponements are made.

In this paper, the phenomenon of the digital economy will be analysed first of all, through the presentation of its main manifestations and problems for fiscal purposes.
The aim of this work will, therefore, be to analyse the economic and technological context of reference for the introduction of a new system of taxation of "digital" profits, in order to be able to subsequently study and comment on the various solutions identified, at supranational and the domestic level, to identify what new legislative developments could be, both domestically and internationally (in particular, at the European level).

In particular, this work will analyse in the first chapter the birth and development of the digital economy and its main characteristics. This will serve as a premise for understanding how the large digital enterprises have engaged in elusive behaviour by eroding their tax bases and transferring profits to countries with privileged taxation.

In the second chapter, it will be examined how the OECD has undertaken numerous initiatives to address the problems arising from the increasing digitalisation of the economy and the progressive affirmation of new business models. In a nutshell, the OECD, through the BEPS Project, has prepared a series of measures to counter the spread of aggressive tax planning strategies and to fill the gaps in existing tax systems, devoting an entire line of action (Action 1) to the issue of taxation of the digital economy and another (Action 7) to the revision of the definition of permanent establishment.

The European Union, in turn, has identified solutions to ensure effective taxation in the light of the digital transformation of the economy, approving initially the proposals for a Directive on the common corporate tax base (CCTB) and the common consolidated corporate tax base (CCCTB) and subsequently the proposals for a Directive on the

introduction of a notion of permanent establishment where the connecting factor is the concept of "significant digital presence" [COM (2018) 147 final] and on the establishment of a "tax on digital services" [COM (2018) 148 final].

Finally, in the third and final chapter, the various unilateral proposals of individual countries will be analysed. The OECD reports accept and indeed, in some ways, encourage the formation of temporary unilateral (national) solutions, pending the long-term international decision, certainly more effective, but complex and not easy to implement. Many countries, such as Italy, India, the United Kingdom, Spain and France, have introduced very different rules for the taxation of digital enterprises. These are the so-called web taxes, *i.e.* the indirect taxes applied to the turnover achieved by each country, formed according to the indications of the OECD. The main aspects of these solutions are analysed and in particular, the critical issues and numerous doubts that arise in this regard are highlighted.

All the interventions share the intention, declared or implicitly, to hit the digital economy in the broadest sense, identified in most of the cases in the so-called "web giants".

CHAPTER I

DIGITAL ECONOMY

SECTION 1

1. Foreword

The process of economic globalization and the incessant development of technology and communication devices have led to a strong innovation in the way of doing business. The growing technological innovation has led to the emergence of new and specific business models but has also influenced the way in which the various sectors of the economy are managed. The exponential growth of the internet, which has seen its development with the creation of the worldwide web (the so-called network), has offered economic actors new business opportunities. Companies, in fact, through the web, are able to enter a market that is born by its very nature as global and have the possibility to adopt entrepreneurial strategies with a distinctly transnational character, aimed at maximizing profits and minimizing costs. In particular, on the one hand, companies have the possibility, to develop their activities in distant geographical areas, by means of the high ease of deploying the equipment they use; on the other hand, they can intercept distant markets in a timely and effective manner and easily reach the final consumer[2]. It has also been possible for companies to penetrate foreign markets without the need for a real establishment with a fixed seat or with their physical presence in the territory of the country of the source. This is possible thanks to the completely innovative and mostly immaterial models of business which are adopted to operate and realize profits in countries different from that of residency.

These new business models have, however, highlighted the inadequacy of the current national and international tax system to intercept the income generated by web-based companies and subject them to taxation in accordance with traditional rules and

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[2] Leo M., *Quale tassazione per l'economia digitale,* in *Il Fisco*, 21/2018, p. 1-3.

procedures. The current tax legislation therefore fails to appropriately address the new business models of what has been called the digital economy. It has been noted in particular that the digital economy, dominated by large tech multinationals (such as Google, Facebook, Amazon, etc.), is capable of generating very high incomes, but this income can be difficult to tax[3]. The inadequacy of the present tax system is the result of a tax system designed for a material economy, still focused on the requirements of materiality and spatial fixity, while the wealth generated by the digital business is characterized by its immateriality and its a-territoriality[4]. In particular, in online transactions, unlike traditional transactions, it is not possible to refer to the classical physical elements – the property transferred and the place of disposal – which enable the productive economic activity of income to be linked to the territory of a given State. The transactions carried out online, in fact, are characterized by an absolute degree of immateriality, so that the consequent manifestations of ability to contribute are hardly attributable to the territorial sphere of a country that can then subject them to taxation[5].

2. Digital Economy: Framework

The birth and the growth of digital economy is the result of a transformation guided by information and communication technologies (so called ICT – *Information and Communications Technology*), or all the methods and technologies that realize the systems of transmission, receipt and information[6]. How, however, is the digital economy defined? On what basis and characteristics, that is, an economy can be defined as digital rather than falling within the canons of the traditional economy?

According to a first reconstruction, the digital economy would be a context in which the economic transactions and functions that govern the enterprises, the institutions

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[3] Gallo F., *Fisco ed economia digitale,* in *Diritto e Pratica Tributaria*, 4/2015, p. 600-610

[4] Guarino S., *La nozione di stabile organizzazione nell'era dell'economia digitale,* in *Corriere Tributario*, 9/2018, p. 716 ss.

[5] Molinaro G., *La tassazione della ricchezza derivante dall'economia digitale,* in *Il Fisco*, 39/2015, p. 2-3.

[6] Miccoli, G. (2016). *Digital economy: le multinazionali e i nuovi modelli di business,* PM Edizioni. Varazze: PM, p. 2-6.

and the community are programmed and executed with the support of digital technologies[7]. Other authors instead define the digital economy as the state of the economy that is manifested through the continuous technological innovation that influences the production of goods and services and the distribution of the same, as well as the communication between the subjects of the economy (producers, intermediaries and consumers). Economic activities carried out by enterprises in the digital economy are common to those of previous economic eras. The digital economy is characterized by exchanges of non-physical goods, that is, goods not included in material supports. This is well summed up by the expression that "digital good may be everything and nothing"[8].

In general, the digital economy can be defined as that new form of economy, increasingly interconnected with the traditional and evolving one, based on information technology and encompassing all activities using and referring to digital solutions. However, it is not easy to identify a precise notion of the digital economy; and this difficulty is due to the various forms that it can take. Reference is made, for example, (i) to electronic commerce, that is to say to that set of commercial transactions (purchase, sale, delivery) that take place between seller and buyer through a worldwide network of telematics communication, (ii) to the sharing economy, which, through a digital base of goods and services, allows users the use of certain goods for a period of time against consideration and (iii) to the activities of the so called Over The Top (*e.g.* Google, Facebook, Skype).

If there is therefore a difficulty in establishing a priori what the digital economy is and in giving it a definition, it is however possible to outline its fundamental characteristics. In particular, elements intrinsic to the digital economy are:

- territoriality: the digital economy is formed and developed without any tangible link with the territory of wealth creation;
- transnational: through the use of the new media, business operating in the digital economy can easily cross-national borders;

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[7] Valdani E., *I quattro fondamenti dell'economia digitale,* in *Economia & Management*, 3/2000, p. 51-67.
[8] Rosembuj T., "*Taxing Digital"*, in El Fisco, 2015, p. 13.

- dematerialisation: the digital economy allows operations to be carried out without material elements. It is based mainly on non-physical exchanges and the transfer of goods not included in physical media (*e.g.* software, app, e-book)[9].

3. Main Features of the Digital Economy

Once the key elements of the digital economy had been identified, efforts were made at international level (particularly within the so-called "OECD") to determine the characteristics of this new economy, in order to develop new tools, procedures and principles to attract income generated by digital multinationals to taxation.

The characteristics of the digital economy have been identified in five profiles:

1. mobility, to be appreciated in relation to intangible assets on which the digital economy is based, to users (and professional users) and to the localization of the operating functions of the enterprise, in respect of which the development of ICT allows a division of functions and allows entrepreneurial activity to be placed in different states;
2. extensive use of personal and other data concerning consumers, suppliers or transactions. Through the tools made available by digitisation, businesses collect user and consumer data about online operations, to obtain important information in order to provide greater customization of services, create new products and diversify within the market;
3. network effect, which is created thanks to interactions and synergies between users. In particular, this effect is reflected in e-commerce and the sharing economy, where users, before taking their final decisions, are confronted with the opinion of other consumers, relying very often on the reviews and opinions of those who have already purchased the same product or have used the same service;

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[9] Leo M., *Quale tassazione per l'economia digitale,* in *Il Fisco*, 21/2018, p. 1-3.

4. tendency to create monopolies and oligopolies. Digital companies can achieve a dominant position in the market in a short period of time, by combining the network effect with low incremental costs;
5. volatility, created by the speed of technological innovation and the presence of almost no entry barriers for new companies in the sector[10].

It is thanks to these features that digital companies have been able, under the current tax system, to reduce their tax burden, erode tax bases and transfer profits to countries with a more advantageous tax system (tax havens). Given the high degree of dematerialisation of the digital economy, such enterprises can avoid having a taxable presence, through a permanent establishment, in the territory of the State in which they are operating, and they divide, assets and risks in the territory of more than one State. The presence of highly remunerative intangible assets allows their intra-group transfer with the sole purpose of minimising the tax burden[11].

4. Business Model of the Digital Economy

The concept of the digital economy includes economic activities very different from each other; to date, we have not yet reached a complete classification of the different business models present online[12].

In any case, the models that appear most relevant, both for the economic importance they have assumed and for their particular characteristics, are the electronic commerce, the sharing economy and the activities of the so-called Over the Top companies.

Electronic commerce has been defined by the European Commission as "*the conduct of business activities by electronic means, based on data processing and transmission, including various activities such as the marketing of goods and services,*

[10] Gallo F., *Indagine conoscitiva sulla fiscalità nell'economia digitale, Audizione Commissione Finanze della Camera dei Deputati*, 24th February 2015, p. 1-4.

[11] Gallo F., *Indagine conoscitiva sulla fiscalità nell'economia digitale, Audizione Commissione Finanze della Camera dei Deputat*i, 24th February 2015, p. 2-4.

[12] Cellini P., *Economia Digitale: l'industria e i mercati di internet e dei nuovi media,* Luiss University Press, 2015.

online distribution of digital content, direct sales to the consumer and post-marketing services, including traditional and new goods, services and activities"[13]. In the same sense, the OECD, which defined electronic commerce as "*any commercial transaction taking place on open networks, such as the Internet*", "*Generally refers to all forms of business activity, both for organizations and individuals, which rely on the processing and transmission of digitized data, including text, sound and visual images*"[14].

In other words, electronic commerce is defined as the whole of any commercial operation carried out by electronic means. In the light of this broad interpretation, electronic commerce encompasses a variety of activities, such as the marketing of goods and services by electronic means, the online distribution of digital content, the conduct of financial and stock exchange transaction, etc. as well as all preparatory and subsequent activities to the actual commercial operation.

E-commerce is distinguished either by the way the goods are delivered or by the entities operating in the system.

According to the first distinction, based on the mode of delivery of the goods being traded, electronic commerce is divided into:

- indirect electronic commerce: the object of the commercial transaction is a tangible good, the delivery of which takes place by correspondence, through physical or traditional channels;
- direct electronic commerce: the object of the commercial transaction is an intangible asset, which is delivered by electronic means[15].

Therefore, in the first category, the web constitutes one more modality to contact the customer, in addition to the traditional methods, since the realization of the commercial transaction then happens with the physical and material delivery of the good: an order of tangible goods is executed electronically, but then the goods are delivered through traditional channels (*e.g.* postal service, couriers, etc.).

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[13] Communication from the European Commission COM (97) 157, A European initiative on electronic commerce, 15th April 1997.

[14] OECD/GD (97) 195, *Measuring Electronic Commerce,* 1997.

[15] Tomassini A., *Stabili organizzazioni e commercio elettronico,* in *Corriere Tributario*, 19/2013, pp. 1467-1498.

On the other hand, in direct electronic commerce the delivery of the good also happens within the web, for which the entire commercial operation is completed online. The object of telematics transaction can be, regardless, a supply of goods or services: in the first case, the goods traded online are called digital goods, which can take the form of software, e-books, songs in mp3 format; in the case of provision of services, ticket services, banking and insurance services and information services are provided directly via the internet.

From the fiscal point of view, indirect electronic commerce bears much fewer problems than direct: in the first case, the transaction has as object the cession of tangible good and there is an effective displacement of the goods sold, for which the transaction is not easily concealable. Instead, in the case of direct electronic commerce, the entire transaction takes place on the net, thus leaving few identifiable traces of the operation, making it extremely difficult for tax authorities to control the payment of taxes relating to such transactions[16].

Concerning the parties involved in the transactions, the electronic commerce is subdivided in:

- B2B (business to business): the commercial transaction between two companies is a transaction in which an entrepreneur sells products or provides services to another entrepreneur; in such relationship the final consumer is not involved. The IB (intra business), in which the negotiation takes place within the same company or group of companies, is distinguished in the context of the relationships between companies;
- B2C (business to consumers): the commercial transaction between an enterprise (seller) and a final consumer (buyer). In this sector are offered to all users of the network goods and services of the most varied types, through virtual shops in which there are catalogues and lists freely accessible to visitors of the site, followed by more and more detailed information to illustrate in the best possible way the product to the potential buyer;

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[16] Mocci G., *Commercio elettronico diretto: ecco perché l'IVA è un fattore distorsivo della concorrenza,* in *Il Fisco*, 48/2000, pp. 14361 ss.

- C2C (consumer to consumer): electronic exchange takes place between end-users, such as online auctions, where consumers offer and look for products. In this case, businesses involved in C2C e-commerce play the role of intermediaries, helping consumers to sell or buy products by publishing information online and facilitating transactions[17].

Electronic commerce has established itself worldwide in a few years and is still subject to constant and exponential growth. This is due to the huge range of goods and services provided online and the very easy access to the network by all users, bringing so many benefits for both customers (*e.g.* wide choice of products and services, customization of the same, reduction of prices given the high competition, the possibility to easily compare offers of different suppliers, etc.), and entrepreneurs (*e.g.* presence in a global market, savings on brokering and marketing costs, opportunities to target their products and services).

As previously said, the second business model of the digital economy is represented by the sharing economy.

The sharing economy constitutes, according to the definition proposed by the Revenue Agency itself, "*that new economic and cultural model based on the equal exchange of goods and services, as an alternative to buying them as typically happens in the traditional economy. The mechanisms of operation of the shared economy (sharing economy) allow private entities, which do not operate in a professional way on the market, to use their private property and to provide services for economic and lucrative purposes. Such a system of sharing turns out more present in the fields of crowdfunding, the transports, the services of exchange of goods of consumption and the tourism*"[18].

The sharing economy is therefore a new economic model based on the use and exchange of goods and services, rather than on their purchase. Examples of such business model can be found in car sharing, which allows the user to book a car through an app on his

[17] Santacroce B., Ficola S., *Il commercio elettronico: aspetti giuridici e regime fiscale,* Maggioli, 2014.

[18] *Audizione del direttore dell'Agenzia delle Entrate in relazione all'esame della proposta di legge AC 3564 concernente la "Disciplina delle piattaforme digitali per la condivisione dei beni e servizi e disposizioni per la promozione dell'economia della condivisione"*, 26th July 2016.

phone and use it for a limited period of time by paying for its use, and home sharing, where users make their properties available to other users in exchange for a fee. Such examples are the result of the evolution of the sharing economy and, through the online platforms that manage the various services (respectively, to quote the most famous, car2go for car sharing, Airbnb for home sharing) their spread is increasing.

Despite its different forms, the sharing economy can be characterised by the three following elements:

1. the sharing, that is the common use of a good which differs from the traditional forms of purchase;
2. the horizontal relationship between the parties involved, unlike the traditional forms of relationships based on an entrepreneur and a consumer;
3. the presence of a digital platform supporting such a relationship[19].

The sharing economy in any case poses various difficulties to the taxation procedures of the income deriving from it. Under the current tax system, the exchange of a good or service outside the exercise of an organized professional activity allows private individuals to avoid the fiscal discipline to which the operators in the same sector are subject. This situation distorts the competitive structure of the market to the detriment of business and professionals, and results in substantial losses of revenue since the proceeds from the shared economy are outside the traditional tax system.

5. Effects of the Digital Economy

The continuous evolution and flow of the digital economy and the consequent development of new business models have enabled companies operating in the sector to carry out their activities as real global companies, often limited to a purely digital presence in the individual states in which they were operating. The digitization of the economy in particular allowed:

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[19] Gasparri T., *Nuove regole per la sharing economy,* in *Il Fisco*, 43/16, pp. 6 ss.

- expanding the possibility for consumers to shop online and for businesses to sell products and services to consumers around the world, without the need to be physically present in the State in which the transaction takes place;
- the possibility of reaching out to private individuals for advertising;
- an easier acquisition and management of information and data provided by users: "data" has acquired enormous importance for digital businesses as it is the key to the new way of advertising, more targeted and personalized based on the most probable needs of the consumer[20].

The digital economy has thus changed the way of considering and perceiving the market; no longer appreciated as a physical place of exchange of proprietary rights according to the interaction between supply and demand, but as an open place, without edges and always connected, in which you can access freely, exchanging information of any kind as well as goods and rights of enjoyment, temporary and shared[21].

Digital companies have thus adopted increasingly global strategies aimed at maximising profits and minimising costs, including tax costs. These strategies are based on the development of various business activities in distant geographical areas, implemented through the extreme ease of deploying the necessary equipment almost everywhere and through the possibility of being able to split without consequences the phases of the production process. They are also based on the ability to reach, thanks to the internet, its customers wherever they are, and the immaterial nature of the transmitted digital assets (so-called intangibles).

We are talking about "*nations without wealth, riches without nations*"[22], meaning that there no longer exist those previously well-defined boundaries that marked the economy. If businesses develop in a climate of globalization, on the contrary, national tax systems

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[20] Valente P. - Ianni G. - Roccatagliata F., *Economia digitale e commercio elettronico: fiscalità in internet nella gestione d'impresa,* IPSOA, 2015.

[21] Uricchio A. - Spinapolice W., *La corsa ad ostacoli della web taxation,* in *Rassegna Tributaria*, 3/2018, p. 451.

[22] Cipollina S., *I redditi nomadi delle società multinazionali nell'economia globalizzata*, in *Rivista di diritto finanziario.*, 2014, p. 21.

are becoming less and less coordinated, thus favouring the exploitation of tax asymmetries between national tax systems.

The main problem, therefore, is to intercept the income of digital multinationals and to find new ways of taxing all those incomes which are generated by "over" territories, while remaining without a homeland[23].

[23] Micossi S., *La fiscalità d'impresa nel nuovo mondo globalizzato e digitalizzato,* in *Assonime, Note e Studi*, 1/2017, p. 7.

SECTION 2

1. Critical features of the Digital Economy

The digital economy, as previously analysed, is characterized by the ability to allow digital companies to carry out commercial operations regardless of material elements that connect transactions to a given territory. In the digital economy often the development of the commercial activities happens without the enterprise having to resort to a physical structure, limiting itself to take advantage of the market of the territory without resorting to some material or personal support in the same territory[24].

Therefore, in telematic transactions, due to the absence of a physical link with the territory of the State in which the wealth is created, the traditional taxation criteria of the transnational tax system are not capable of ensuring a fair distribution of tax power, to the detriment of the source States.

While there has been a continuous and constant development of the digital economy, on the other hand this growing evolution has led to the crisis of traditional concepts such as those of residence and permanent establishment, because the dematerialisation of the digital economy makes it particularly easy to avoid a "taxable presence" in the territory of the State where the digital enterprise operates and produces wealth[25].

The area of ordering that has been found less suitable to regulate the activities of the neo-economy was the tax system[26].

Focusing the scope of analysis on income taxation, we begin to introduce, in general terms, the principles on which the tax regulations are based.

A State exercises its power of taxation, with regard to the calculation of taxes on the income produced by an entity, following two principles of taxation:

(i) the taxpayer's tax residence and,

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[24] Pedaccini F., *L'imposizione diretta nel contesto dell'economia digitale: stabili organizzazioni "virtuali", ritenute fiscali e la diverted profit tax,* in *Rivista Trimestrale di Diritto Tributario*, 4/2015, p. 3-5.

[25] Palumbo G., *Prospettive di una nuova tassazione dell'economia digitale,* in *Il Fisco*, 44/2017, p. 2-3.

[26] Tremonti G., *Il Fisco «vecchio» di fronte a Internet*, in *Il Sole 24 Ore*, 25th September 2016, p.23.

(ii) the source of income.

The tax residence of an entity is located in the territory in which it concentrates the centre of its business, therefore a State can exercise its sovereignty, at the level of taxation, on the income that an entity, tax resident within the State produces, anywhere in the world, according to the principle so-called "*Worldwide taxation principle*".

On the other hand, there is the general principle of taxation at source, according to which income tax is levied in the State in which income is generated. This principle is applied regardless of the State in which the person is resident. This system may lead, in the case of persons engaged in activities outside their State of residence, to a case of double taxation, in which income is taxed both in the State of residence and in the State of production of income. Problems of this kind are mitigated by bilateral agreements, which provide for tax arrangements that vary according to the type of income produced.

The most widely used method is based on the principle that income is taxed in the country of the source where it is produced, and regarding the country of residence, through the recognition of a tax credit, to eliminate the problem of double taxation.

On the other hand, when a non-resident collective entity carries on economic activity in a tax jurisdiction different from that of the country of residence, the connecting criterion is a legal entity that allows the physical location of the source of a transnational income. This link is identified by a fixed place of business, represented by the so-called "permanent establishment". The identification of the permanent establishment is a criterion for linking to a tax jurisdiction the income of a foreign enterprise in the territory of a State other than that in which it is resident. The permanent establishment, therefore, represents the factual circumstances of the economic activity which an entity, outside the legal system, carries out on the territory of the State. It represents, at the legal level, a way to legitimize the State to exercise its tax sovereignty over the income produced by an entity, which is not resident in the State.

In general terms, a person who carries out an organized economic activity, in a State through a fixed seat, is subject for the income produced through the organization to the taxation of that State. The condition necessary for the detection of the presence of a permanent establishment is that the foreign person carries out through it a commercial

activity, putting in place an organization of activities, having such circumstance, when the organizational structure shows elements that are necessarily connected to a stable presence of the activity in the State.

It is the physical articulation of a society in a foreign State, representing the basis by which a society carries out its activities in a State other than that of residence.

The importance of the institution described above is crucial to tax income produced by foreign companies. It is clear from this that the fiscal principles on the basis of which States can exercise their sovereignty are based on concepts of linkage of a material nature.

It is the material/physical nature of the institutions behind the tax system that badly adapts to the characteristics of the digital economy by preventing the effective translation of these principles into the virtual world. In particular, the concept of a permanent establishment, inextricably linked to infrastructures and non-existent staff on a specific territory, comes into crisis when compared to the business models of the digital economy that generate intangible and a-local wealth. Digital companies are able to operate in different states without making use of those structures on the ground that would allow them to be qualified as permanent establishment according to traditional rules[27].

The developments introduced by the digital economy therefore involve a necessary revision of the territorial linkage criteria to be connected with the taxation of the income deriving from the performance of activities attributable to the digital economy[28].

Having regard to the increasing difficulty in returning such incomes to taxation, there is a need to carry out a systematic restructuring of the current tax system and to introduce new criteria which will allow activities carried out in the territory of a State other than that of residence to be attracted to taxation, but not attributable to a permanent establishment[29].

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[27] Tomassini A., *Stabili organizzazioni e commercio elettronico*, in *Corriere Tributario*, 19/2013, p. 1467-1498.

[28] Marè M., *Le sfide del fisco nell'economia digitale,* in *Il Sole 24 Ore*, 19th April 2017.

[29] Giovannini A., *Ripensare la capacità contributiva,* in *Diritto e Pratica Tributaria*, 1/2016, p. 29-31.

The proposals for revision of the connecting criterion enhanced the correlation with the economic life of a country, arriving therefore to a new ratio of the source criterion as the basis of the allocation of the tax power[30]. The assumption on which these proposals are based is that wealth should be taxed in the State where value is created. If, however, the international tax system traditionally identified the value of a transaction in its selling price, with the consequence that the seller of the good or the service provider created the value through the production of the good or service itself[31], a new definition of "created value" is now proposed: this definition is based on the assumption that, in the provision of digital services to users, the value for the provider is represented by the participation of the users themselves.

The principle is therefore that it is the participation of the user who generates the value for the digital enterprise and such participation, which is expressed in the access and use of digital interfaces such as websites, social networks and apps, is relevant whether or not users pay a fee to access the digital interface[32].

Moreover, analysis carried out by the European Commission shows that the "*digital economy depends to a large extent on intangible assets, such as user data and advanced methods of data analysis to extract value from user data. Such practices are increasingly used to generate value in multinational groups and are difficult to assess*"[33].

Users' data are therefore today one of the most important assets for companies operating in the digital economy sector, which allow them to achieve large profit margins. The acquisition of data by companies is not free of charge, but is achieved through an exchange relationship that characterizes in an onerous sense these services. In this perspective, the States represent not only a market for the services offered by digital

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[30] Fransoni G., *La web tax: miti, retorica e realtà,* in *Rivista di Diritto Tributario*, 4/2018, supplemento online.

[31] Spinapolice A., *La corsa ad ostacoli della web taxation*, in *Rassegna Tributaria*, 3/2018, p. 451.

[32] Della Valle E., *La web tax italiana e la proposta di Direttiva sull'Imposta sui servizi digitali: morte di un nascituro appena concepito?,* in *Il Fisco*, 16/2018, p. 5-8.

[33] Communication from the European Commission COM (2018) 147 final, Proposal for a Council Directive laying down rules for the taxation of companies with a significant digital presence, 21th March 2018.

companies, but also a supply market[34], thus changing the way companies view the exploitation of the market.

In this sense, it has been stressed by the doctrine that the choice of linking the tax power of a State to the participation of users is in line with the theory of benefit: the tax is linked to the benefits granted by States to enterprises in terms of the services offered[35].

The need, in any case, for a revision of the territorial link criterion and in general of the existing tax system has become increasingly urgent in recent years, given that, in the current context of inadequacy of the traditional tax system. Digital multinational companies have succeeded, through a capillary fiscal planning, to withdraw to tax the wealth produced from the transactions put in place online and to transfer the incomes to preferential tax regimes. The critical nature of the tax system in force in relation to the digital economy has contributed to the spread of phenomena of the so-called "aggressive tax planning"[36].

1.1 Permanent Establishment

The concept of a multinational enterprise is used to indicate an undertaking which has commercial relations with the foreign countries.

With regard to this phenomenon, there are a number of different situations which correspond to different ways of acting. An enterprise can export goods and services abroad without an actual fixed physical presence on the territory of other States maintaining, therefore, the organizational activity only within the country in which it has its residence.

The enterprise, as another solution, may decide to carry out a fixed installation in a foreign territory by exercising its activity and carrying out part of its production in another contracting State. Furthermore, a multinational undertaking may operate in the

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[34] Palumbo G., *Prospettive di una nuova tassazione dell'economia digitale, op.cit.*

[35] Hongler P. - Pistone P., *Blueprints for a new PE nexus to tax business income in the era of the digital economy,* in *IBFD Working Paper*, 20th January 2015.

[36] Valente P., *Raccomandazioni OCSE su Economia Digitale, Abuso dei Trattati e Transfer Pricing,* in *Il Fisco*, 39/2014, p. 3859.

territory of the States in which it carries on its business through one or more subsidiaries or associates (subsidiaries) or, as a last resort, it may carry on activities on international markets using independent suppliers or distributors.

The parent company, which can also be defined as an "exporter", operates without fixed bases in the territory of other States, so the production of an income in those States must be examined in the light of the principle of territoriality applied to the different categories of income separately considered.

There is a permanent establishment (hereinafter PE) if the enterprise operates in foreign markets and territories through a fixed place of business. In this way, the company assigns the whole local distribution chain to independent companies from a commercial and management point of view, but at the same time renouncing a profit share that is acquired directly by the intermediaries. On the contrary, in the event of a mere export of goods and services to other States, it is considered to be a circumstance that does not give rise to taxation abroad since there is no activity in the territory of other States.

Thus, the establishment of the fixed place of business in the foreign States determines a new set of tax relations between the State of residence of the enterprise and the State of the source of the income. In fact, the formation of the permanent establishment entails the creation of a tax claim by the State of source.

The PE in relation to the taxation of a business activity, has been a very important tool to ensure that a country can impose taxes on companies resident in another contracting State.

Enterprises used the characteristics of this institution to by-pass the payment of taxes, to avoid double taxation and to be able to operate in countries other than that in which they have their residence. Hence the need for a particular study of the permanent establishment with regard to the concept, legal qualification and its relationship with the parent company.

Subsequently, the developments that have occurred in recent years regarding electronic commerce and the different operations of multinational companies in transnational markets and systems has led to a greater analysis of this institute.

The PE is a tax-law institution which is relevant to the taxation of international business[37]. It has conventional origin and is regulated by the OECD in the current Art. 5 of the OECD Model Convention, and over time obtained a discipline and a treatment also at the national level in Italy (Art. 162 of the single text of income taxes, hereinafter T.U.I.R.) and in other States.

The notion of a PE can typically be identified in the "organization of activity"[38] as a typical criterion for recognising a non-resident collective in a tax jurisdiction different from that of the country of residence. The institution is described at international level in the OECD Model Convention, and it is indicated: "as a centre for the imputation of the legal situation, with a wide managerial, functional and accounting autonomy that however is discerned by an autonomous subjectivity that is not in fact recognized"[39].

Article 5 of the OECD Model provides a general definition of a permanent establishment. First, it identifies two categories of PE (material and personal), secondly, it proposes in relation to the material permanent organisation a list of cases of existence (*positive list*) and a list of cases of non-existence (*negative list*). Finally, it provides clarification on the general definitions of this institution.

"The concept of a permanent establishment includes under a single name two qualitatively distinct economic phenomena: a) the exercise abroad of an activity by a series of material means organised directly by the economic operator (stable physical organisation); b) presence on the foreign market without direct exercise of activity, but by means of a representative, expressed through different legal modalities and figures and therefore with a less intense material bond (personal permanent establishment)"[40].

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[37] Garbarino C., *Stabile organizzazione*, in *Rivista di diritto tributario,*1998, p. 365.

[38] Boria P., *L'individuazione della stabile organizzazione*, in *Riv. dir. trib*., 2014. pp. 1 -25.

[39] Lovisolo A., *La stabile organizzazione*, in V. UCKMAR (a cura di), *Corso di diritto tributario internazionale*, Padova, 2002, p. 340.

[40] Lovisolo A., *La stabile organizzazione*, in V. UCKMAR (a cura di), *Corso di diritto tributario internazionale*, Padova, 2002, p. 300.

"Material" permanent establishment means a PE with a fixed place of business, with physical assets and staff, through which the foreign undertaking carries out all or part of its economic activity in the territory of the State[41].

Therefore, in relation to such hypothesis of PE the subsistence of at least three elements is necessary: a) existence of a fixed place of business, that is a structure as an example local or in some cases, machinery or equipment; b) permanence or stability character (fixed) of the installation; c) connection with the pursuit of the business activity.

With regard to the fixed place of business this requirement is identified as a "limited area in which the business activity is carried on"[42].

The term place of business includes all premises, buildings or machinery, structures or equipment used to carry out the business activity of the enterprise; it is relevant that the activity of the enterprise is carried on in whole or in part within the fixed place of business, which is in a physical space.

It can be noticed that the presence of permanent staff in a permanent establishment does not influence the determination of a permanent establishment[43]. According to the OECD commentary, the work of companies is generally carried out with the help of staff, but there are cases, such as gaming machines[44], where the use of staff can be limited to the installation phase only, the control or maintenance of the equipment, but in such circumstances if the undertaking is concerned not only with the installation of the equipment but also with the maintenance and vital operation of the equipment, then the aforementioned equipment can be configured as PE[45].

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[41] OECD, *Model Tax Convention on income and on capital*, 2014, art. 5. par. 1: «*For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on*».

[42]Lenz R., *Les conventions suisses de double imposition*, Lausanne, 1957, p. 105.

[43]Della Valle E., *La nozione di stabile organizzazione nel nuovo Tuir,* in *Rassegna Tributaria,* 5/2004, p.1960.

[44] OECD, *Commentary of Model tax convention on income and on capital*, 2014, art. 5, par. 10, p. 216.

[45] From this point of view, it should be pointed out that the concept of permanent establishment for income tax purposes differs from that for VAT purposes as developed by the European Court of Justice. In fact, the latter submits that, in relation to that charge, the permanent centre of activity referred to in art. Article 9 of the Fourth Directive of 1977 implies an appropriate combination of human and technological resources. In this regard in the field of VAT, the Implementing Regulation n. 282/2011 states that "*The permanent establishment designates any organisation, other than the place of business [...] with a sufficient degree of*

Another important aspect to be analysed is the irrelevance of the fact that the buildings or installations are owned or available to the company through a lease, in fact, in relation to this, there is a tendency to allocate "prevalence of substance over form"[46].

A fixed seat can therefore also be constituted *by a pitch in a market place* if it is used permanently as a customs warehouse (for example, for the storage of goods subject to duties).

It is also made clear that no formal legal title is required to confer the right to use a particular place of business; in fact, one can speak, therefore, of a fixed place of business about a space of which one has the permanent availability from part of the enterprise, as long as it shall carry on its business there.

The condition of permanence or fixity ("fixed") refers to the requirement of stability, which in relation to the definition of a PE refers to the structure (fixed place of business): both in spatial and temporal sense, or, either from the point of view of its location or from the point of view of its permanence. Therefore, "the stability of the installation must be used with a minimum temporal regularity and have its own geographical space"[47].

Stability of a place of business occurs when there is an inseparable link between the business location and a given geographical location[48].

Regarding, instead, the temporal data, the commentary reports that the place of business in order to be fixed, and therefore, in order to consider a permanent

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permanence and a suitable structure in terms of human and technical means to enable it to receive and use the services provided to it for the needs of that organisation, or to provide the services for which it provides services". See Council Implementing Regulation EU No. 282/2011 of 15 March 2011 laying down implementing provisions for Directive 2006/112 EC on the common system of value added tax; Roccatagliata F., *Per la stabile organizzazione occorre una idonea combinazione di risorse umane e tecnologia*, in *Corr. trib.*, 2015, p. 2022.

[46] OECD, *Commentary of Model tax convention on income and on capital*, 2014, par. 4, p. 210.

[47] D'Alfonso G., *La stabile organizzazione fa il suo esordio in Italia*, in *A&F*, 2003, p. 10.

[48] OECD, *Commentary*, cit., par. 5, p. 212: «*since the place of business and a specific geographical point* [...] *since the place of business must be fixed, it also follows that a permanent establishment can be deemed to exist only if the place of business has a certain degree of permanency, i.e. if it is not of a purely temporary nature*».

establishment as such, needs that the fixed centre in question has a certain degree of stability, thus is not of a purely temporary nature[49].

As a last requirement there is the connection between permanent establishment and business activity resident in another Contracting State, that is the instrumentality of the fixed place of business. In fact, a place of business is considered a permanent establishment as well as for the presence of a stable and permanent business centre also on the basis of another requirement: a connection is required between the activity carried out by the non-resident enterprise and the activity carried out in the place of the territory where the place of business is situated. There must be an intrinsic link with the pursuit of activities. "The traceability of the activity to that of the enterprise is understood in the sense that the PE must serve in order to actively exercise at least one of the business activities"[50].

Materiality and fixity are the characteristics that recur in the positive list of the Art. 5, paragraph 2 of the OECD Model, which provides, for example, a list of examples of fixed business premises representing a material PE, such as the presence on the territory of a State of a management, branch, office, workshop, laboratory, place of extraction of natural resources (mine, oil or gas well, quarry). It is from the *positive list* that the third requirement necessary for an installation on the territory of the State is grasped like material PE: the instrumentality of the centre in relation to the exercise of the typical activity of the non-resident enterprise. Hence the irrelevance, for the purpose of defining the material PE of the preparatory or auxiliary activities, contained in the so called *negative list*[51].

This list provided in paragraph 2, although not exhaustive, gives a number of examples which constitute a material permanent establishment. The list shall consider:

a) a place of management;

b) a branch;

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[49] OECD, *Commentary*, cit., par. 5.3, pp. 212- 213.

[50] D'Alfonso G., *La stabile organizzazione fa il suo esordio in Italia*, in *A&F*, n. 14/2003, p.10.

[51] Guarino S., *La nozione di stabile organizzazione nell'era dell'economia digitale*, in "*Corriere Tributario*" n. 9 del 2018, p. 716.

c) an office or office;

d) a workshop;

e) a laboratory; and

f) a mine, oil or natural gas field, quarry or other place extraction of natural resources also in areas outside territorial waters where, in accordance with customary international law and national legislation on the exploration and exploitation of natural resources, the State may exercise rights relating to the seabed, subsoil and natural resources.

The place of management is the place where management activities are carried out. It should be specified that the concept of "*place of management*" does not overlap with that of "place of effective management" on which the taxpayer's tax residence depends: the concept of residence is incompatible with that of a permanent establishment, the latter being relevant for taxation of the sole non-resident undertaking, that is, the undertaking which does not have its "main object in the territory of the State"[52].

The reference framework of the permanent establishment shall be supplemented by the treatment of the personal permanent establishment[53] regulated at the conventional level of the par. 5 and 6 of the OECD Model. From the definition point of view, this type of PE is characterized by the presence of a negotiating activity in favour of the foreign enterprise, not sporadic or occasional, carried out with a habitual character by agents (par. 5) and by independent agents (para. 6), having the power to bind the foreign enterprise. The latter shall conclude contracts in the territory of the State, in the name and on behalf of that undertaking, for the supply of goods or services, other than the purchase of goods.

The notion of "employee"[54] is first of all attributed with a negative meaning, in fact it is defined as a person who is not an independent agent referred to in par. 6 of Article 5 OECD model. On the other hand, it is a company or a natural person which, because of the extent of its powers or the nature of its activity, is capable of binding the non-resident

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[52] Cerrato M., *Sui confini tra esterovestizione societaria e stabile organizzazione*, in *Rivista di diritto tributario*, 2013, parte V, pp. 55-72.

[53] Salvini O., *La nuova definizione di stabile organizzazione nel BEPS*, in *Rass. trib.*, 2016, p. 69.

[54] Lovisolo A., *Il concetto di stabile organizzazione nel regime convenzionale contro le doppie imposizioni*, in *Dir. prat. trib.*, 1983, pp. 315.

enterprise in relation to certain activities carried out in the State in question. The assessment of independence from the foreign undertaking shall be determined by reference to the extent of the obligations binding the agent in relation to the undertaking itself. On the contrary, it is indicative of a state of dependence that the enterprise is subject to detailed instructions or general control or that it takes action to replace it, which, however, is economically relevant in its legal sphere.

Turning to the specific treatment of the discipline to par. 5 Art. 5 of the OECD Model provides that, where a person other than an agent with an independent status acts on behalf of an undertaking and habitually exercises in a Contracting State the power to conclude contracts with the name of that undertaking, that undertaking has a permanent establishment in that State in relation to any activity undertaken by that person, unless the activity of that person is limited to that referred to in paragraph 4 which, if exercised by means of a fixed place of business, would not make that place of business a permanent physical establishment within the meaning of that paragraph[55]. This rule therefore provides that a foreign undertaking has a permanent establishment in a foreign State in relation to any activity carried out by that person for that undertaking, except where the activity of that person is limited to those referred to in paragraph. 4 of the same provision, for which *ex lege* is determined an exclusion to be considered as a permanent establishment (*negative list*).

The conditions which must be fulfilled in order to consider a permanent personal establishment as integrated, are: a) the usual conclusion of contracts on behalf of the foreign enterprise, and also b) the fact that the agent is not an independent intermediary acting in the framework of his normal business.

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[55] OECD, *Model Tax Convention*, cit., art. 5, par. 6: «*Notwithstanding the provisions of paragraphs 1 and 2, where a person – other than an agent of an independent status to whom paragraph 6 applies — is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph*».

The requirement of habituality coincides with that of stability provided by the physical establishment. According to the doctrine, the requirement of habituality is determined on a case-by-case basis, in relation to the nature of the contracts and the activity of the principal[56]. It is important that the person is physically present with a certain habituality in the territory of the State or has his residence there.

Therefore, the fundamental and substantial feature that makes it possible to identify the existence of a permanent personal establishment is that of the habituality of the instrument adopted to operate in the foreign country[57]. The factors justifying the equivalence of the dependent agent to the permanent establishment are "the exclusivity of the relationship of collaboration" and "the subordination of the agent", so it is explained the total indifference of the agent about the economic results of the enterprise.

As for the material PE, we have evidenced some hypotheses of exclusion so, there is a paragraph dedicated to the clarification of particular circumstances in relation to the hypotheses of exclusion of the permanent personal or immaterial establishment. It is stated, in fact, in par. 6 Art. 5 of the OECD Conventional Model that an undertaking is not regarded as having a permanent establishment in a Contracting State simply because it carries on its business in that State through a mediator, a general commissioner or any other intermediary enjoying an independent status, provided that such persons act in the ordinary course of their business[58].

2. Tax Planning

Digital multinational companies have changed their business strategies, including fiscal ones, exploiting the affirmation and evolution of information and communication technologies, so as to widen the number of users, reduce operating costs and thus increase

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[56] Garbarino, C. *Manuale di tassazione internazionale*, Milano, 2008, p. 335.

[57] Lovisolo A., *La stabile organizzazione*, op. cit., p. 315.

[58] OECD, *Model Tax Convention,* cit., Art. 5, par. 6: «*An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business».*

profits. The constant growth of the digital economy has in fact allowed digital companies, as we have seen, to manage their commercial transactions by providing goods and services almost anywhere in the world, but without showing any taxable presence, and adopting global business models that allow them to carry out your business in a more favourable tax environment[59]. In order to increase their profits, it is natural for companies to seek to locate their investments where profitability is higher, thereby assessing the level of taxation, the principles that characterise the tax system of a particular country and the way in which tax administrations operate: these are all factors that can influence the profitability of an enterprise and its investment decisions[60].

These assessments and the subsequent operational choices of multinational companies are part of what is called "international tax planning", an essential tool for optimising the tax burden and increasing profits.

Fiscal planning involves the analysis of the principles governing the tax system in which the enterprise operates and the consequent development of techniques aimed at optimising the tax burden. International tax planning therefore combines strategic and operational needs of the company with the results of the analyses carried out, by favouring the design of an articulated enterprise structure through which the objective of profit maximization is pursued[61].

Fiscal planning has always been seen by different countries as a legitimate practice. However, over time and with the evolving digital economy, tax planning structures have become increasingly sophisticated and complex, so as to generate a debate at international level on the legality of the behaviour of multinational companies, which consists in exploiting the existing distortions in the various legal systems to optimise the tax burden. Tax planning has led to a significant erosion of the tax base of companies operating in the digital economy sector, through the exploitation of the fiscal

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[59] Salvini O., *La strategia anti-BEPS nell'economia digitale: la revisione del criterio di collegamento,* in *Rassegna Tributaria*, 3/2017, p. 768.

[60] Valente P., *Elusione fiscale internazionale,* IPSOA, 2014, Milano.

[61] Valente P., *Manuale di Governance Fiscale,* IPSOA, 2011, Milano.

misalignment that occurs internationally and through the transfer of profits to countries with reduced or zero taxation.

It is therefore necessary to outline the boundaries within which tax planning can be considered legitimate and when, on the contrary, leads to aggressive tax planning[62]. Aggressive tax planning schemes consist of practices which, although formally legitimate, run counter to the objectives and spirit of internationally recognised principles; such practices therefore reduce the amount of tax payable by multinational companies through legal transactions in the strict sense, but which are nevertheless contrary to the purpose of the rules.

As stated by the OECD itself, "*responsible conduct in the tax field implies that companies respect both the letter and the spirit of the laws and tax regulations of all the countries in which they carry out their activities, cooperate with the authorities and make available to them the necessary information or information required by law. An undertaking behaves in accordance with the spirit of tax laws and regulations if it takes reasonable steps to determine the intention of the legislator and interprets the tax rules in accordance with that intention, in the light of the relevant text and contemporary jurisprudence. Transactions should not be structured in such a way as to result in tax outcomes that are incompatible with the economic consequences of such transactions, unless there is specific legislation designed to produce such a result. In such a case, the undertaking should reasonably consider that the transaction is structured in such a way as to generate tax burdens for the undertaking itself which are not contrary to the intention of the legislator*"[63].

Aggressive tax planning has been defined by the European Commission as "*exploiting for its own benefit the technical aspects of a tax system or the existing disparities between two or more tax systems in order to reduce the amount of tax due*"[64].

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[62] Della Rovere A. - Viola I., *Prospettive della digital economy in ambito internazionale, europeo e nazionale*, in *il Fisco*, 10/2019, p. 948.

[63] OECD, *Guidelines for Multinational Enterprises,* 2011, par. 100.

[64] Commission Recommendation C (2012) 8806 of 6th December 2012 on aggressive tax planning.

In light of such definition, aggressive tax planning is characterized by three elements:

- the exploitation of disparities between different tax systems with the aim of obtaining a tax advantage. Multinational companies, through the creation of complex financial schemes, take advantage of the fiscal misalignment that occurs internationally. Since every jurisdiction has tax rules that differ, from those of other countries, making use of this disparity it is possible for companies to completely escape taxation or at least to lower their tax burden;
- the mismatch between the production of wealth and the state power of taxation. Through the creation of these complex financial schemes, the multinational company moves the profits of the enterprise towards a State with a privileged tax regime, thus creating a mismatch between the place where the wealth is produced and the State in which the corresponding taxes are paid;
- the existence of an "involuntary" double non-taxation. The exploitation of the disparity between tax systems and the resulting tax advantage obtained by multinational companies should in any event not be considered as a form of double non-taxation which the states have specifically decided to allow[65].

In order to combat the phenomenon of aggressive tax planning, a number of initiatives have been taken at the international level (particularly within the OECD) and at the EU level to minimise the risk of tax base erosion. This will be analysed in the following chapter.

It notes, however, that the phenomenon of aggressive tax planning and the consequent problem of tax base erosion are issues to be addressed in a coordinated and shared way, possibly through international agreements[66].

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[65] Pistone P., *La pianificazione fiscale aggressiva e le categorie concettuali del diritto tributario globale,* in *Rivista Trimestrale di Diritto Tributario*, 2/2016, pp. 395 ss.

[66]As the European Commission itself points out in the Communication from the European Commission COM (2016) 23, Anti-circumvention Package: next steps to ensure effective taxation and greater tax transparency in the EU, 28th January 2016, "*unilateral action by Member States would not adequately solve the problem of aggressive tax planning and would create problems. The adoption of uncoordinated measures against the transfer of profits is likely to be counterproductive. Addressing this cross-border*

3. Digital Companies and Tax Avoidance

A 2016 study, published by the European Parliament, estimates that the annual revenue evaded by multinationals in EU countries amounts to EUR 160-190 billion[67]. The Competition Commissioner, Margrethe Vestager, has carried out numerous sanctions for undue state aid involving tax avoidance by multinational companies.

The European Commission has introduced in January 2016 the proposal of Anti Tax Avoidance Directive (ATAD 1) that it has entered into force in 1st January 2019, after being approved by the European Parliament and the European Council.

The Directive accepts the recommendations of the OECD report on combating tax base erosion and profit transfer. The Directive is divided into six points:

- avoid the implementation of the transfer pricing mechanism that allows the transfer of profits to countries with lower taxation;
- limit the deductibility of interest payments, since high-interest loans are often made from a group company resident in a tax haven to another resident in a high-tax European country;
- controlling intangible assets of companies with a high innovation rate, such as patents. Research is often carried out by companies in one country, and then intellectual property rights are allocated to subsidiaries in tax havens;
- Member States are prohibited from entering into agreements in order to obtain a tax advantage for companies without valid commercial reasons. This ban has been included in the directive because countries such as the Netherlands,

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problem with divergent national approaches can provide loopholes for aggressive tax planning. The rules in force in one Member State may impair the effectiveness of the rules in force in other Member States. Moreover, a non-coordinated approach may lead to uncertainty and administrative burdens for businesses and may further encourage sub-optimal responses from Member States.

Aggressive tax planning is a global problem that requires solutions at European and international level. Many Member States have now recognised that unilateral action is not enough and there is a broad consensus that a coordinated response to the issue of aggressive tax planning is necessary if fair conditions of competition are to be guaranteed in the field of taxation".

[67] European Parliament. 2019. *QUANTIFICATION OF THE SCALE OF TAX EVASION AND AVOIDANCE / 2015*. [online] Available at: <https://www.europarl.europa.eu/legislative-train/theme-deeper-and-fairer-internal-market-with-a-strengthened-industrial-base-taxation/file-quantification-of-the-scale-of-tax-evasion-and-avoidance> [Accessed 16 March 2020].

Ireland and Luxembourg have granted preferential agreements to multinational companies;

- legislation will be introduced towards non-EU countries from 2020, which regulates financial instruments, so as to avoid misalignments from hybrids so as to exclude double non-taxation, which results from differences in the regulation of different jurisdictions;
- try to prevent double non-taxation of certain types of profits, switchover rule. One of the ways in which double non-taxation can be achieved is by multinationals controlling subsidiaries which reside in tax havens, such subsidiaries distribute dividends which are not taxed either in the resident country or in the EU country.

3.1 Difference Between Tax Avoidance and Tax Evasion

It is possible to say that tax evasion is a concept quite distinct from tax avoidance, although there is no precise definition of the two terms.

Tax evasion belongs to the area of illicit tax and involves the concealment of the taxable matter, that is, the assumption of the tax that should apply. The aim is therefore to conceal and combat the tax burden on taxpayers. Such conduct may be sanctioned both in criminal and administrative matters.

Tax avoidance is a form of abuse of law, which is declined in acts, facts and shops that produce effects incompatible with a regulatory ratio. It is a transparent phenomenon that does not manipulate factual reality[68].

Tax havens give investors the opportunity to evade income taxes generated by other countries, resulting in considerable savings for taxpayers. Tax savings arise when it is possible to assign an asset to an entity present in a tax haven or alternatively by assigning this activity to a tax haven only in a fictitious way, or by exploiting the envisaged secrecy regime and hiding the actual structure of the operations. Tax heavens

[68] Basilavecchia M., *Funzione impositiva e forme di tutela*, Torino, Giappichelli, 2018, p.251.

offers several instruments for avoiding income tax, for example, contracts or other intra-group transactions may be concluded to transfer taxable income.

Operating in different States, multinationals are subject to different tax regimes and this entails the risk that they may be subject to double taxation, but at the same time they may be subject to double non-taxation, which would give them a significant tax advantage.

Over time, multinationals have tried to make the most of this tax advantage and have developed aggressive tax planning to avoid taxes. These companies manage to avoid them in countries with high taxes, exploiting the differences between the different national tax systems and trying to make profits from jurisdictions with lower taxation.

3.2 Different Way to Avoid the Tax System

3.2.1 Permanent establishment

In the current globalized economic context, as we have already seen, it is common to see some circumvention practices to transfer the profits made by a company to states where the tax system is most advantageous. The attainment of this aim is also effected by the use of artificial means to circumvent the permanent personal organization and specifically, making use of the figure of the commissionaire.

In fact, one of the tools used by multinational companies not to operate abroad through a stable organization was to replace their distributors in foreign countries with commission agents, without, however, changing in substance the functions performed.

(i) Commissionaire arrangements: these are agreements whereby a person sells products in a State in his own name, but on behalf of an enterprise, the owner of the same. A foreign enterprise, with this practice, is able to sell products in a State without having a permanent establishment to which revenue can be attributed for tax purposes and without, therefore, paying tax on income generated in that State; since the person who concludes sales legally does not own the products, he cannot be taxed on the profits that result, but only on the

commission he receives for his services. Therefore, a foreign company that uses a commissionaire agreement does not have a permanent establishment because it manages to avoid the application of Art. 5 par. 5 of the OECD Conventional Model. The company acts with the formal conclusion of contracts in the name of the foreign company, modifying the terms without making any substantial changes to the functions carried out in a State. By formally complying with the above, it is established that an independent commission agent operating in his ordinary course of business could never be considered as a permanent personal organization except for the fact that it applies the use of the name of the proposer[69].

In this case, the person in question would fall into the category of "independent agents" and would not give rise to the case of permanent establishment.

In fact, according to Article 5, it is possible that the hypothesis of a permanent establishment may arise if a person acts in a State on behalf of an undertaking, concluding contracts in a repeated manner, but the following conditions must also apply: the person must enter into contracts on behalf of the enterprise in a customary manner, or habitually perform the role of independent agent, which leads to the conclusion of contracts with other parties; contracts may be in the name of the enterprise or for the transfer of its ownership. In addition, in accordance with the OECD, the permanent establishment is not limited to cases where there are parties who conclude contracts in the name or on behalf of the foreign company, but it extends to the eventuality in which these subjects furnish a contribution to their conclusion. Therefore, those who carry out essential acts in the conclusion of agreements for the enterprise must also be qualified as "employee agents".

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[69] Buonamassa G. – Gerardi G., *Stabile organizzazione e commissionario*, in *Bilancio e reddito d'impresa*, 2017, p. 19.

Participation in negotiations, under the control of the foreign company, can integrate the existence of a permanent personal establishment, as the sending to the parent company of contracts that are approved without changes

Since the Article provides that the existence of a permanent establishment depends on the formal conclusion of contracts in the name of the foreign undertaking, it is possible to circumvent the application of the rule by amending the terms of the contracts, but without making any material changes to the functions performed in that State.

(ii) Use of the exceptions in Article 5.4: the Article excludes certain cases from the automatic assignment of the status of permanent establishment to the place of business of an undertaking in a State. These are general exceptions, which apply only where the activities in question are of a preparatory[70] or auxiliary[71] nature.

Since the introduction of these exceptions, there have been important changes to the way in which activities are conducted; in fact, operations that could previously be considered preparatory or auxiliary, today could represent the characteristic activity of a society[72]. This will be better analysed in the second chapter, in particular in the section on Action 7 of the BEPS project.

3.2.2 Transfer Pricing

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[70] "*An activity that has a preparatory character is one that is carried on in contemplation of the carrying on of what constitutes the essential and significant part of the activity of the enterprise as a whole. Since a preparatory activity precedes another activity, it will often be carried on during a relatively short period, the duration of that period being determined by the nature of the core activities of the enterprise. This, however, will not always be the case as it is possible to carry on an activity at a given place for a substantial period of time in preparation for activities that take place somewhere else. Where, for example, a construction enterprise trains its employees at one place before these employees are sent to work at remote work sites located in other countries*" (OCSE, Model Tax Convention on Income and on Capital, Commentary on article 5, paragraph 4, November, 2017).

[71] The decisive criterion is whether the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole. (OECD, *Glossary of Tax terms*).

[72] OECD/G20, Base Erosion and Profit Shifting Project, *Preventing the Artificial Avoidance of Permanent Establishment Status*, Action 7: 2015 Final Report, Executive summary, pp. 9-13, october 2015.

The term transfer pricing means the procedure for determining the prices of commercial transactions between companies belonging to the same group, located in different countries. Transfer pricing is increasingly at the centre of the tax authorities' attention, as its manipulation would allow income to be shifted to countries with preferential taxation. These practices would enable the enterprise group to obtain undue tax savings.

In the case of a group of undertakings, the tax base is to be reduced, with explicit advantages for the group of undertakings. This procedure can be applied also without resorting to the exchange of goods or services, directly involving the business costs. Naturally such elusive behaviour would not come to light if the price that the two parties exchanged, in intercompany transactions, were adequate to the market value.
As stated by the OECD[73], "*normal value*" is based on the arm's length principle and represents the price that two independent companies would set for the same transaction.

To determine transfer pricing, OECD guidelines distinguish between methods traditional and based on income.

Traditional methods are:

- used price comparison (CUP): the price charged by undertakings belonging to the same group is compared with the price charged by independent undertakings for the same good or services in comparable transactions;
- resale price (resale minus): a gross profit margin is deducted from the resale price of the goods, which is determined by comparing it with the margin realised by the undertaking selling to third parties or the margin guaranteed by the undertaking buying from third parties, the resale price is normalised". This method is used when a group company deals with the sale of products from all associated companies;
- higher cost (cost plus method): a gross profit margin is added to the costs incurred, which is determined by comparing it with the margin realised by the

[73] OECD (2018), *Additional Guidance on the Attribution of Profits to Permanent Establishments, BEPS Action 7,* www.oecd.org/tax/beps/additional-guidance-attribution-of-profits-to-a-permanent-establishment-under-beps- action7.htm Accessed 15 March 2020].

enterprise for sale to third parties or with the margin guaranteed by the enterprise in purchases from third parties. This method is usually applied when an undertaking sells materials to another group company, which will then process them, to sell the final product on the market.

Methods of income are:

- split profit method: it consists in attributing the total profit of the operation to every enterprise of the group, according to a criterion of distribution of the profits conforming to that that would have been fixed between independent enterprises for the same transaction;
- net margin method: consider the net margin that the company achieves in the transition and compare it with that which it would obtain on the free market, and, if this is not possible, the net margin should be compared with that of another independent company operating on the free market in similar transactions.

The OECD in its analysis has focused in particular on the analysis of intangible assets, since for the latter it is more difficult to compare with other transactions and therefore the correct stabilisation of "*normal value*".

As it has been evidenced previously, the digital companies make wide use of the intangible assets. Being the intangibles a structural component of their business model, multinational enterprises, also in this case, can have opportunity of fiscal elusion. Exchanges are made up of the use of intangible assets, with the aim of improving the production of goods or the use of services (*e.g.* patents, trademarks, software, intellectual property, etc.), and/or the transmission of intangible rights between undertakings belonging to the same group. Licence agreements are generally concluded for the exploitation of intangible assets, on the basis of a fee, better defined as a royalty. In order to identify the fair arm's length price, the OECD suggests that licensing agreements covering the same intangible assets should be analysed and compared.

Among the operators of the digital economy, the most used business model foresees the creation of multiple local subsidiaries, to which are contractually allocated the business relationships with the national customer/supplier in the main reference

markets. They then use the cost plus method, which provides for the reimbursement of all costs incurred by resident subsidiaries, plus a contractually agreed mark-up, to remunerate intercompany relationships. Risks taken and assets used by local entities shall be remunerated in accordance with the arm's length principle.

3.2.3 Hybrid Mismatch Arrangements

Digital companies implement elusive conduct, using an additional tool, hybrid structures, having business models that allow the exploitation of fiscal asymmetries internationally. Hybrid structures tend to use:

- hybrid transfers: structures that are treated as transfers of ownership of an asset for tax purposes in one country, but not for tax purposes in another country where they are treated as collateralised lending;
- corporate forms having dual residency: corporate forms which are resident in two different countries;
- hybrid corporate forms: corporate forms that are treated as transparent in one country and as non-transparent in another country;
- hybrid instruments: instruments that, for tax purposes, are treated differently in the countries involved, generally as debt capital in one country and as venture capital in another one[74].

These are therefore techniques which enable the differences between national jurisdictions to be exploited in order to derive a tax advantage, which may result from a double deduction, from a deduction in one State and from the non-imposition in the other or from the artificial formation of a tax credit.

Examples will now be given to explain how companies can evade tax through hybrid mismatch arrangements.

A typical example in cases of double deduction occurs when a company A, resident in State A, has indirect control of a company B, the latter resident in State B.

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[74] Oecd.org. (2020). [online] Available at: https://www.oecd.org/ctp/aggressive/le-strutture-ibride-tematiche-di-politica-e-compliance-fiscale.pdf [Accessed 5 Mar. 2020].

Between the two companies there is a hybrid entity, which controls Company B, but which in turn is controlled by Company A. In such cases, for tax purposes, the hybrid entity is recognised as a transparent entity by State A, as a non-transparent entity by State B.

Now we assume that the hybrid entity increases the capital of company B, using new third-party funding, and assume that, in addition to the interest payable, the hybrid entity does not detect other relevant income movements. The result will be that the hybrid entity will pay income tax to the State; however, as we know, interest payable may be deducted from the tax base. On the other hand, State A charges Company A and Company A deducts the hybrid entity's interest payments from its tax base. The resulting effect is to generate a double tax deduction.

The OECD devoted action 2 of the BEPS project[75] to fight the effects of hybrid mismatch arrangements. The first part of the final report on the second action contains recommendations for making changes to internal laws, so as: (i) to refuse to exempt dividends where these have been deducted in other States; (ii) to block the use of hybrid transfers exchanged only for the purpose of artificially creating tax credits; and, (iii) to improve the CFC regime so that hybrid entities are taxed in the parent company's jurisdiction and financial intermediaries are obliged to exchange information on hybrid mismatch arrangements.

4. Tax Ruling

The opportunities of tax avoidance above described are, for the most part, captured by the digital companies, because they have business models that allow the full exploitation of fiscal asymmetries at the international level. The legal institution that will now be developed, namely "*tax ruling*", is not among the techniques used by

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[75] OECD (2015), *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/9789264241138-en.

multinational enterprises in particular, but is also used by large multinationals that are not part of the digital sector or do not sell their products on the Internet.

First of all, it must be stressed that there is actually no binding general legal definition of Tax rulings[76].

As pointed out, in the US a tax ruling is mainly considered to be "*a written declaration furnished to the taxpayer or his legal representative by the national office, containing an interpretation and application of tax legislation to a specific case*"[77].

In some other cases, mainly in Europe, tax rulings are rather identified in agreements or decisions having an administrative character, as in the Netherlands or in Italy[78]. Moreover, due to the common preventive character of the instrument concerned with respect to the legal situation which constitutes its object, commentators often refer more specifically to "advance tax rulings" to indicate the measures at stake[79].

Tax ruling can be defined as an advance ruling in the tax field, by which the authorities of a country inform a firm in advance of the manner in which they will calculate the total amount of tax which the entity will have to pay into the treasury's coffers. This instrument is open to abuse in the context of international tax planning.

The tax ruling, as it is understood, has come to the forefront of the news following the "*Luxleaks scandal*", which was the result of a journalistic investigation in 31 countries that uncovered a mechanism, at that time perfectly legitimate, which allowed large multinationals to evade tax payments.

Branched secret agreements with Luxembourg, giants like Amazon, Ikea, Deutsche Bank, Procter & Gamble, Pepsi and Gazprom, could move huge amounts of money for paltry

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[76] However, it should be noted that the EU legislator has recently undertaken steps in this regard, by introducing the definition of "*advance cross-border ruling*" and "*advance pricing agreement*" in Dir. 2011/16/EU as amended by Dir. 2015/2376/EU, regulating administrative cooperation in tax matters.

[77] Romano C., *Advance Tax Rulings and Pronciples of Law: Towards a European Tax Rulings System*, (University of Groningen: IBFD, 2002) p. 485.

[78] Romano C., *Advance Tax Rulings and Principles of Law: Towards a European Tax Rulings System*, University of Groningen: IBFD, 2002, p. 486.

[79] Nevertheless, it might be argued that precisely because of the preventive nature inherent in the definition of "advance tax ruling", such latter instrument should be better considered as a sub- category of the larger *genus* of general tax rulings rather than a synonym (as the European Parliament confirms) (European Parliament, Directorate-General for Internal Policies, Policy Department A – Economic and Scientific Policies, *'Tax Rulings' in the EU Member States*, Study for the ECON Committee, 2015, p. 28.

imports[80]. The analysis of the accounting records showed how many multinationals resident in Luxembourg have avoided paying millions of euros in taxes, due to the application of tax rates of less than 1%. The *luxleaks* scandal played a decisive role in demonstrating the strong use of secret agreements aimed at obtaining substantial tax reductions. The European Parliament has begun to implement a series of measures to fight this phenomenon.

In addition to Luxembourg, the focus is on other countries which allow companies to benefit from tax advantages, primarily the Netherlands and Ireland.

Ireland, without being considered a tax haven, offers a favourable tax regime by applying a rate of 12,5% on commercial incomes and agrees to the application of aggressive fiscal policy mechanisms leading to the imposition of even lower rates.

The Netherlands, on the other hand, allows multinationals to transfer large amounts of money, simply by setting up a letterbox company, in exchange for a very small percentage.

These two countries permit the application of the largest and most famous scheme for transnational tax avoidance known as the "*Double Irish with a Dutch Sandwich*". This is a tax avoidance technique used by some large multinationals involving the use of a combination of Irish and Dutch subsidiaries, with the aim of shifting profits to a jurisdiction that applies a minimum income tax rate or does not apply at all. This technique is mainly used by web giants, because, without having a physical rooting in a territory and operating outside the international criteria, they do not have a place of production but only a sales activity. For tax purposes, therefore, the location of intellectual property, which is very often found in the hands of an Irish subsidiary, is of particular importance.

In particular, we refer to the so called "*Over The Top*" enterprises such as Google, Facebook, YouTube, Twitter. Under the definition of "Over The Top" (so-called OTT)

[80] Il Fatto Quotidiano. 2020. *Blog | Il Tax Ruling Tra Regole, Violazioni Ed Evasione Fiscale Da Parte Delle Multinazionali - Il Fatto Quotidiano*. [online] Available at: <https://www.ilfattoquotidiano.it/2016/11/06/il-tax-ruling-tra-regole-violazioni-ed-evasione-fiscale-da-parte-delle-multinazionali/3170196> [Accessed 15 March 2020].

fall therefore those companies that, thanks to the use of the telematic network, provide users with services of "rich media", or those forms of content, services and advertising that leverage the interactive potential of the web (e.g. personalized advertising). These companies benefit from the global sharing space created by the internet, but without being the owner of the network infrastructure: in so doing, the OTTs are able to turn to a potentially infinite number of users, without having to bear the costs of installing and maintaining such infrastructure. In all these cases users access the portal free of charge, but in return they provide their own personal information: these are the real added value of the digital economy, as the sale of such data to operators interested in the commercial content of these profiles allows the OTTs to make huge profits[81].

This kind of businesses earn income that are struggling to identify, to locate and to tax. In particular, what is of concern in all States other than the State of residence (USA), is the criticality that creates the application of the traditional link criterion of the permanent establishment.

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[81] Vannucchi G., *Internet e le dinamiche dei ruoli degli OTT (Over The Top) e Telco nel panorama ICT,* in Mondo Digitale, 5/2015, p. 2-19.

SECTION 3

1. Case Study

1.1 Google

The technique of the "Double Irish with a Dutch Sandwich" has been made famous in particular by Google.

Unlike Apple, which will be analysed in the next paragraph, Google builds its core business solely and exclusively on intangible assets, as we have seen previously these services range from streaming to email service, and we must also add services that range from Cloud computing to online advertising.

This allows a planning of the group much more flexible and modular. Thanks to their core business, the trim of Google is easily centralized in little strategic consociates.

The scheme provided, firstly, for an agreement between *Google USA* and its subsidiary *Google Ireland Holding* (GHI), established under Irish law but resident in Bermuda, with which the American parent company transferred to GHI the rights to exploit its technology on all countries (excluding the USA). There was also a further agreement between GHI and a Dutch company, wholly owned by GHI, which had no employees and no activities but had sub-licensed the exploitation rights of Google technology.

Finally, the scheme provided that the Dutch company, in turn, would cede the rights in question to a third company (also part of the group and also resident in Ireland). The latter was the only company actually operating and its function was to invoice all the profits that the Google Group made globally (excluding always the USA). Considering that, due to the type of services it performs, Google was able to sell the same around the world without any physical presence in the various countries, the profits in question were not taxed in the States where they were made. Instead, they all came to the company resident in Ireland, where they would have to pay the 12.5 % tax.

However, the Irish company (which received revenue from all over the world), through the transfer pricing instrument, assumed to have to remunerate the company

performing the “most complex” functions (because it had the right to exploit the intangibles), it considerably lowered its tax base through the payment of royalties to the Dutch company which licensed the rights to exploit the technology. These royalties were not subject to withholding, as the Irish system did not provide for withholding on outflows paid to companies resident in the EU. Thus, the Irish subsidiary lowered the tax base by deducting royalties from the Dutch company which licensed it to exploit the technology.

Therefore, the Irish subsidiary lowered the tax base by deducting the royalties paid to the Dutch subsidiary, but was not subject to deductions on the same. On the other hand, the Dutch subsidiary, which received these revenues, brought them down substantially by paying substantial royalties to the first Irish company (GHI) which licensed it technology exploitation rights. These latter royalties were also not subject to exit withholding tax, which was not provided for in this hypothesis by the Dutch tax system. Finally, income received by GHI was not taxed in Ireland, since the latter company, although incorporated under Irish law, was based in Bermuda, a tax haven which provides for exemption from business income tax.

The choice to make an adequate remuneration for intangibles (rights to exploit Google’s technology in all countries except the USA) through the transfer pricing instrument has played an important role in the scheme. In particular the criterion of distribution of the profit of the transactions used is that of the Transactional Net Margin Method (TNMM). Applying this method, the net profit margin (understood as a portion of the total profit of the group within which the transaction took place) attributable to an undertaking is to be calculated by reference to the net margin that the same company would have received in the course of comparable free market transactions.

Therefore, in the case of an undertaking belonging to a group, within which one or more aggregate transactions are carried out which contribute to the determination of the final profit of the group, the profit margin attributable to the individual undertaking must be in line with that which would have been attributed to it if it had carried out similar transactions on the free market (under the so-called arm’s length principle). In order to apply this method correctly, it is then necessary to identify within the group the undertaking to be tested and then the undertaking to which the comparative assessment

has to be made. Therefore, if the profit derives from the synergic activity of more enterprises, each of which makes a specific contribution, and every enterprise is remunerated for its contribution, there will be a different net profit margin allocated to each enterprise. The problem therefore arises from identifying the firm in which to carry out the test. The OECD Guidelines provided that the choice should be compatible with the functional analysis of the transaction. It follows that most of the time the part to be tested will be that for which the functional analysis is less complex and thus the undertaking to which the lowest profit margin will have been attributed.

It is precisely by applying these methodologies that Google, on the assumption that the more complex functions were performed by the group companies that owned intangibles, managed to dislodge the majority of profits to these companies.

1.1.1 Focus on Italy

In the Italian territory, Google avails itself of the work of Google Italy S.r.l., a company controlled by Google Inc., whose object is the provision of consultancy services and assistance in sales support activities in the marketing and advertising sector. A series of tax assessments have been undertaken against this company with the main aim of identifying the existence of legal requirements for the establishment of a permanent establishment in Italy by Google Inc. and Google Ireland Ltd.

Based on the inspection activity carried out, Google Italy S.r.l. was considered a permanent establishment in Italy of the companies Google Inc. and Google Ireland Ltd, as it was found that:

- the existence in Italy of a specific site, consisting in a physical installation, through which Google Ireland Ltd and Google Inc. have carried out their activity in an instrumental and non-auxiliary manner;
- the availability of this place has been unequivocally continuous and such as to supplement the requirement of the fixity of the activity on the national territory;

- the organization of the means, in consultation with the human resources employed on the Italian territory, has been suitable, prodromal and finalized to the production of the entire income developed in Italy, through the conclusion of contracts with the Italian customers;
- the tax liability in Italy of revenue accrued in Italy has in fact been avoided on the basis of the contents of the general service contract, artificially put in place with the sole purpose of simulating the exercise by Google Italy Srl of a mere ancillary and preparatory activity, which however did not find any evidence in the acquired elements[82].

In the light of these findings it was found that Google Inc. and Google Ireland Ltd have been operating for years in Italy with a permanent organisation that is not formally declared and not formally constituted (*i.e.* hidden permanent organisation).

In view of this finding, in May 2017 Google reached an agreement with the Revenue Agency to resolve the issue without controversy, defining it through an assessment with adhesion.

Google then undertook to pay the Italian Treasury a sum of EUR 306 million.

In November 2012, the tax authority of Milan started tax investigations against Google Italy S.r.l. to verify the correct fulfilment of tax obligations in Italy. In 2007 it had emerged that between 2002 and 2006 Google had recorded an undeclared income of 240 million and unpaid VAT of more than 96 million. As a result, the revenue agency has decided to undertake a number of control activities with regard to multinationals, in particular, Italy has also taken action against the erosion of the tax base caused by the shift of profits to more tax advantageous jurisdiction[83].

A breakthrough in relations between Google and the Italian tax office took place on May 4, 2017, when an agreement was signed between the representatives of the American giant and the Revenue Agency with which it was established that the American

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[82] *Interrogazione parlamentare del Sottosegretario Vieri Ceriani relativa agli accertamenti tributari effettuati nei confronti del gruppo Google*, 28th November 2012.

[83] "*La Guardia di finanza contro Google Italy: ‹‹Riescono a non pagare le tasse nel nostro paese"››*, in *Il Sole 24 Ore*, 28th November 2012.

company would have to pay EUR 306 million to the Italian Fiscal in order to resolve the dispute concerning the period between 2002 and 2015. With this agreement were also established the criteria that Google would have to follow to declare corporate income related to the activity on the Italian territory. Moreover, this was followed by further prior arrangements for the proper taxation of profits and the pursuit of tax control.

The path to this result has been long, since it is not easy to establish the fiscal boundaries of multinationals and to establish the amount to be paid as different data can be taken into account. First of all, we cannot overlook the fact that in 2015 Google had a turnover in Italy of 637 million euros, of which only 3.4 million euros were paid, equal to the application of a 0.5% rate[84].

The pact between Google and the Revenue Agency represented a way for the US company to reduce administrative sanctions, and the fact that Google paid the amount due before the trial even started, had a "rewarding effect" in the case of the investigation carried out for the omission of the tax return. The origin of the investigation is represented by the discovery by the tax authority of a permanent establishment "not declared" present in Italy with which the Dublin company operated.

The judgment against Google is a relevant case for the controversial issue of the taxation of digital companies. Beyond the penalty aspect, therefore, meaning the income that has succeeded in attracting the Italian tax authorities what derives from that judgment is also of particular inspiration and importance. For the Italian State the most important consequence is the possibility to tax from now on the profits that Google will produce in Italy. An important goal has been the recognition of the taxation in Italy of a share of the profits that in the future will be realized through the activity carried out by the search engine in our country.

Google has signed an Advanced Priced Agreement (APA) that will allow to determine with exactitude the tax base of the Italian society, that is, in a procedure of ruling, homologated according to the OECD rules.

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[84] Mincuzzi A., *Google fa pace (dopo un anno) con il Fisco italiano: pagherà 306 milioni di euro*, in *Il Sole 24 Ore*, 4th May 2017.

With the signature of the procedure, Google has undertaken to submit to the Revenue Agency a ruling application in which the transfer prices will be correctly defined to arrive at establishing the actual tax base.

This agreement has also led to some implications on the level of investment supported by the group in Italy. In this sense the company of Mountain View will modify its business model in order to make so that Italy becomes the distributor of services for the great customers. A larger part of the business will therefore pass from our country.

The closure of the Google case marks a step forward in the attempt to counter the phenomena of tax erosion by large multinationals, in particular those of the web that are more oriented to circumvention and with greater capacity are able to escape the tax.

1.2 Apple

A similar scheme to that of Google is the one that has been the subject of special rulings granted by Ireland to Apple Inc. The US parent company (Apple Inc.) owned 100% of two companies incorporated under Irish law but not resident in Ireland: *Apple Sale international* (ASI) and *Apple Operations Europe* (AOE). The two companies had entered into a *Cost Contribution Arrangement* (CCA) with Apple Inc., which provided for the attribution to them of all the rights of use of intangibles (including ownership of the right of use of Apple) and also provided that the subsidiaries would make annual payments to their parent company in the USA to finance its research and development activities in the USA on behalf of the Irish companies[85].

The CCA also envisaged that these payments would be deducted from the profits recorded by the paying companies. ASI and AOE received a significant share of the group's total turnover. In particular, ASI was responsible for purchasing Apple branded products from manufacturers all over the world and selling these products in Europe.

[85] The deposits, already in 2011 reached the quota of two billion dollars, and they are progressively increased until 2014. These payments, made mostly by ASI, helped to finance more than half of the total research activities carried out by the Apple group in the USA to develop its intellectual property worldwide.

Sales were contractually organised in such a way that customers purchased products from ASI in Ireland instead of from the stores that sold them materially.

In this way, all sales, and the resulting profits, were recorded directly in Ireland. AOE, on the other hand, was responsible for manufacturing and selling some computer lines and was recording its profits in Ireland. Under the Irish tax system, the two companies would have to pay a corporate tax of 12.5% in the country. However, this rate was almost zero thanks to the provision of special rulings with the Irish financial administration. These rulings provided for the two "satellite" companies to operate in Ireland, not on their own, but through permanent establishments, thus becoming subject to Irish law but not resident there.

The parent companies (identified as head offices) were companies not resident in any country, and the latter companies and not permanent establishments held the right to use intangibles. However, given that the profits from sales were flowing to the permanent establishments (and would therefore be taxed in Ireland), it was necessary to consolidate this allocation of profits. The effect was obtained by applying the method described above as TNMM. In particular, provision was made for the simplest functions to be performed by permanent establishments and the more complex functions to be assigned to headquarters.

Therefore, according to the TNMM, the profit margin allocated to the permanent establishments was very small, corresponding to the marginal role they would play in achieving the overall profit. However, most of this profit was diverted to headquarters which, not being resident in any country, were in fact not taxed. As a result, only a small part of the profits achieved was subject to the Irish tax rate of 12,5 %, namely those which according to the TNMM were attributable to the permanent establishments[86].

[86] Doing so, ASI, for example in 2011 (according to figures released during the US Senate public hearings) recorded profits of 22 billion dollars, but has taxed in Ireland only 50 million euros, with a corporate tax of less than 10 million euros and an effective rate of 0.05%. In the following years, despite the profits made by ASI continued to grow, taxes did not increase. For which the EU commission has estimated that in 2014 the effective rate is come down to 0.005%.

Thus, even in the Apple case, it seems clear that the decision to remunerate the usage rights of Apple Inc.'s intangibles through the TNMM method has contributed significantly to the tax-minimising effect.

The tax agreements through which Ireland has for almost twenty years guaranteed Apple an almost insignificant tax burden have been the subject of analysis and subsequent sanction by the European Commission. In fact, within the European Union the rates imposed by Ireland are much lower than those applied by the other States, and therefore applied to other companies, and are outside the scope of pure tax competition in order to approach a State aid case. This is the last point on which the committee focused. The European Commission's intervention is justified by the need to ascertain the extent to which such agreements remain lawful or constitute State aid, hence illegal under Community law.

In June 2014, the European Commission launched an investigation into the tax rulings granted by Ireland to Apple[87] since 1991, according to which Apple has not paid tax in any State in recent years, and brought all profits to Irish companies, paying for these only derisory sums, on the basis of the agreements made with the State. Specifically, Apple has signed with the Irish state, two tax rulings, the first in 1991 and the second in 2007, thanks to which its profits were taxed at a rate of 2% which became the 1% in 2013, then falling more and more over the years, to 0.005% in 2014.

A taxation so much lower than in the other States of the Union has attracted the attention of the European Commission, which has launched an investigation to ascertain

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[87] If, on the basis of a preliminary examination, the Commission finds that the notified measure raises doubts as to its compatibility with the common market, it shall initiate the formal investigation procedure referred to in Article 6 of the EC Treaty. I would like to ask the Commission whether it is prepared to accept Amendment No 108, paragraph 2 of the T.F.U.E., and why it has doubts as to its compatibility with the European single market. The Member State concerned (and further interested parties) may submit comments within a maximum of one month, which may in any case be extended by the Commission. The formal investigation procedure is closed by a decision by which the Commission can declare that: - the notified measure does not constitute State aid; - doubts as to the compatibility of the notified measure with market rules are "dispelled" and the aid must be considered compatible with the common market (cd. positive decision)- the notified measure is incompatible with the common market and cannot be implemented (cd. negative decision).

the nature of the agreements. The investigation was completed in August 2016, with a communication from the European Commission accompanied by a sanction[88].

The Commission has established that the two tax rulings issued by Ireland against Apple "*have considerably and artificially lowered the taxes which the company has paid in that Member State since 1991*"[89]. In particular, the investigation covered two consecutive tax rulings whereby the Irish Government approved a profit allocation method for Apple Sales International and Apple Operations Europe internally. The purpose of the investigation was to establish whether such a method of apportioning taxable profits between the companies in the group might confer an undue advantage on Apple[90].

The Commission's investigation showed that the agreements thus concluded allowed for an internal profit-sharing without any factual or economic justification. The two tax rulings issued by Ireland concerned, in particular, the internal allocation of such profits to Apple Sales International instead of the wider sales structure in Europe, Apple Operations Europe. Specifically, the agreed method provided that most of the profits would not be allocated domestically in Ireland but to a "head office" of Apple Sales International. This "head office" was not located in any country, had no employees or its own offices and its activities consisted exclusively of occasional board meetings.

As a result of the implementation of the tax rulings, the majority of Apple Sales International's sales profits were allocated to its "head office", which was in fact completely non-operational. The "head office", in fact, did not have any employee or of its own offices of reference. The only activities attributable to "head offices" relate to the sphere of decision, since these are few decisions taken by the members of the board of directors concerning the distribution of dividends, certain administrative matters and

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[88] Romano R, *Su Apple arriva la scure di Bruxelles per l'accordo sulle tasse in Irlanda*, in *Il Sole 24 Ore*, 30th August 2016.

[89] European Commission, 2020. *State Aid: Ireland Gave Illegal Tax Benefits To Apple Worth Up To €13 Billion*. [online] Available at: <https://ec.europa.eu/commission/presscorner/detail/en/IP_16_2923> [Accessed 15 March 2020].

[90] Perrone A., "*L'equa tassazione delle multinazionali in Europa: imposizione sul digitale o regole comuni per determinare gli imponibili*?", in *Rivista Trimestrale di diritto Tributario*, 1/2019, pp.77 ss.

treasury management. The only profits generated by these activities were in terms of interests which, according to the Commission's analysis, are the only profits attributable to head offices.

Only a small part of the profits of Apple Sales International was allocated to its Irish subsidiary, which was therefore subject to Irish taxation. The remaining share, the vast majority of profits, was allocated to the head office where it was not taxed. The Irish subsidiary, Apple Operations Europe, was, in fact, the only one among those covered by the tax agreement to boast the operational capacity needed to generate revenue from commercial activity, in particular from the production of some computer lines for the Apple group. The sales profits of Apple Operations Europe should therefore have been registered with the Irish subsidiary and taxed there.

This fact shows how privileged tax agreements stimulate the phenomenon of profit shifting, which the OECD seeks to combat, making even more controversial and complicated the tax regulation of digital companies[91]. The possibility for multinationals to agree with some European States the level of taxation and succeed in obtaining personalized and advantageous tax agreements, represents the conclusion of a circumvention cycle that starts in the States where the companies actually produce their income[92]. Such phenomena, when they occur in an economic and political union of States, cause a problem of aggressive tax competition which exacerbates tax heterogeneity and facilitates tax avoidance.

For some years now, the European Commission has been investigating the extent to which these preferential tax schemes remain within the confines of tax competition or result in State aid.

1.2.1 Tax competition or State Aid?

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[91] Tamburello S., *Ocse, via al piano anti-elusione fiscale da Apple a Starbucks, big nel mirino*, in *Corriere della Sera*, 6th October 2012.

[92] Fubini F., *Fisco, l'Europa contro i big: "basta pagare mini-tasse"*, in *Corriere della Sera*, 17th June 2012.

Fiscal autonomy is a right of the Member States, hence the possibility of arbitrary taxation levels and agreements with multinationals for tax purposes. Arbitration in tax planning has led, with the birth of globalization, to the spread of a particularly incisive phenomenon on the economy of States: tax competition. The European Union, as defined in the Maastricht Treaty, is based on the assumption that individual States are responsible for conducting their own economic policy in order to contribute to the objectives of the Community[93].

Tax competition is not an autonomous phenomenon, but a deliberate condition of the European bodies in order to avoid the excessive increase in taxes in the various legal systems[94].

It is clear that tax competition can degenerate into harmful tax competition. States that engage in aggressive tax planning embezzle tax revenue from others. The instruments used by States to attract substantial tax revenues are agreements for tax purposes, tailored to the company and sector in which they operate, which are the result of a State policy aimed at developing a specific sector in the country, by attracting foreign companies. These institutions are referred to in legal terms as international tax rulings, that is comfort letters issued by tax authorities explaining to a particular undertaking how to calculate corporate taxes or the application of certain special tax provisions.

In the specific case of the Apple-Ireland agreement, the ruling signed had as its object a mechanism to construct the tax base of the company, subjecting the income to a company not resident in Ireland and not operating. The European Commission which conducted the investigation into the tax rulings applied by Ireland has defined these

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[93] Art. 102. (a), Treaty on European Union, 7 February 1992, Maastricht. On this point it is pointed out that Article 99, contained in the Treaty, referred to above, introduces the need for harmonization, with reference to indirect taxes, while in relation to profits all states remain free to tax them arbitrarily.

[94] "*Fiscal competition between countries is a central element of European economic construction, desired, among other things, to avoid that, in the absence of competition between states, rates can increase without limits. Above all, it is logical coherence, because Europe, in the ten years leading up to its establishment as a monetary union, was established as a free market area, based on competition. It is because they distort competition that state aid is prohibited; that is why special rates are prohibited within a country that discriminate against or favour specific companies, industrial sectors, professional activities, geographical areas*". See Franco Debenedetti, "Juncker, la concorrenza e il guazzabuglio fiscale", *Il Sole 24 Ore*, 18 november 2014.

instruments as being contrary to the EU regulation, at the moment they are so advantageous that they confer an economic advantage on one specific undertaking to the detriment of the others which do not benefit from it.

State aid control within the EU is, therefore, an essential tool to ensure that Member States do not reserve better tax treatment for certain companies through tax rulings or other arrangements than others. More specifically, profits should be distributed among companies in the same group and between the different groups in the same company, in a way that corresponds to economic reality. This means that the distribution must be in accordance with agreements which take place on commercial terms between independent undertakings.

In the specific case of Ireland, the European Commission, on the basis of this analysis, concluded that the tax rulings issued by Ireland approved an artificial allocation of the sales profits of Apple Sales International and Apple Operations Europe to their "head offices" where they were not taxed. As a result, the tax rulings allowed Apple to pay less tax than other companies, which is illegal under EU State aid rules.

The European Commission, by decreeing the illegality of the agreements concluded by the Irish Government with the Apple Group, ordered the State in question to recover from Apple unpaid taxes for the period from 2003, totalling EUR 13 billion plus interest[95].

In principle, the EU State aid rules, which require recovery of the incompatible State aid in order to eliminate the distortion of competition it has created, do not provide for fines or punish the company concerned, but they merely impose on the State in error the payment of the tax benefit unduly granted to the undertaking involved in the agreement, restoring equal treatment with other undertakings.

The decision of the European Commission does not call into question the Irish tax regime in general nor the rate of corporation tax applied in the country, but the subject of

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[95] European Commission - European Commission. 2020. *State Aid: Ireland Gave Illegal Tax Benefits To Apple Worth Up To €13 Billion*. [online] Available at: <https://ec.europa.eu/commission/presscorner/detail/en/IP_16_2923> [Accessed 15 March 2020].

the agreement, that is the significant tax benefit granted to Apple, identified in the category of "State aid"[96].

In fact, Article 107 of the Treaty on the Functioning of the European Union (T.F.U.E.) expressly provides that specific State aid liable to distort competition within the EU should be considered incompatible with and detrimental to the European single market[97]. The first paragraph of Art. 107 of the T.F.U.E. orders that, save as otherwise provided in the Treaties, aid granted by States or through State resources, in any form which favours certain undertakings or production shall be incompatible with the internal market in so far as it affects trade between Member States, distort or threaten to distort competition. Any plan to grant new State aid must be notified to the European Commission by the Member State concerned in good time, which also has an obligation to provide all the information necessary to enable the Commission to take a decision on its compatibility with Community principles.

The tax policy pursued by Ireland, as by other European countries, against which the Commission has launched investigations, is the final stage of an elusive mechanism which affects the whole of Europe. This phenomenon shows that there is an increasingly pressing need to provide uniform tax regulations which respect the characteristics of equality typical of an economic and political union.

1.3 Amazon

On 4th October 2017, the European Commission ruled against Luxembourg for breaching of Art. 107(1) TFEU by granting tax benefits to the worldwide operating delivery company *Amazon* of around €250 million[98]. The multinational firm mainly

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[96] Valente P., *Le indagini della commissione europea in materia di "tax rulings" e aiuti di stato,* in *Corriere tributario*, 32/2014, p. 2453.

[97] Article 107 par. 1 of TFEU states: "*Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market*". [98] Commission Decision 6740/2017/EU of the 4th October 2017.

[98] Commission Decision 6740/2017/EU of the 4th October 2017.

operates in Europe through two companies incorporated in Luxembourg: *Amazon EU* (hereinafter *AEU*) and *Amazon Europe Holding Technologies* (hereinafter *AEHT*). Both companies where in the meanwhile subject to the direction of their head holding *Amazon.com* based in the United States and belonging to the latter's group. Contrary to what has been observed with respect to *Apple, AEU* had effectively more than five-hundred employees operating in Europe, where the company was responsible for carrying out the retail activities for the group, which implied buying products from producers and manufacturers, selling them to costumers and consumers and finally deliver them to the ultimate buyer.

The fact that the contracts of sale concluded through *Amazon*'s websites all over Europe did indicate *AEU* as the purchaser's counterparty, all the profits flowing from the sales were automatically shifted into Luxembourg. By contrast, *AEHT* did not have any employees nor facilities in the mentioned Member State, for its activities mainly consisted in providing intermediation between *Amazon.com* and its European branches. Like *Apple Sales International* in *Apple, AEHT* is the holder of the IPRs concerning Amazon's activities as a group, which could be exercised and managed on grounds of a "cost-sharing" agreement concluded between the subsidiary and the US company *Amazon.com*. The agreement foresaw that *AEHT* had to contribute to the costs supported by *Amazon.com* for the development of intellectual property in order to get those rights in exchange, in order to make the group's retail activities in Europe possible. In the meanwhile, Luxembourgish general tax law provided that *AEU* only had to be taxed in Luxembourg, for *AEHT* was a holding company in the form of limited partnership, and thereby it had to be subject to taxation at the level of its partners. Moreover, since 2003 Luxembourg's tax administration granted *AEHT* with a tax ruling endorsing the calculation method applied to the transactions with *Amazon.com* to determine the tax base at arm's length. Again, the firm chose to use the TNNM methodology. In particular, the ruling permitted *AEU* to transfer around three quarters of its actual profits to the holding company *AEHT*. These shifts were provided mainly through intra-group transactions between the former and the latter company, which in turn did not play any role in the management of the group's activities in Europe for all relevant determination were in

reality taken by *AEU*. In order to justify this, Luxembourg and Amazon argued that *"the contested tax ruling concerns transfer pricing and, since only multinational corporate groups are confronted with pricing cross-border intra-group transactions, companies belonging to such groups are in a different factual and legal situation to independent companies"*. The Commission pointed out that *"with that argument, Luxembourg and Amazon advocate for a reference system limited to Article 164(3) LIR*[99]*, the provision of Luxembourg tax law that was considered to lay down the arm's length principle for the purposes of pricing cross-border intra-group transactions during the relevant period"*.

The Commission did not agree with such position because of several different reasons.

Firstly, as it affirms the fact that *"a group company might resort to transacting with associated companies and, in those situations where it does, it must resort to transfer pricing does not mean that group companies are in a different factual and legal situation to other taxpayers for corporate income tax purposes in Luxembourg"*.

On these grounds, it secondly affirmed also that *"the fact that profit has been generated from an intra-group transaction that is subject to Article 164(3) LIR does not mean it is subject to special exemptions or a different tax rate"* and *"consequently, the different manner in which the taxable profit is necessarily arrived at in the case of controlled and uncontrolled transactions has no bearing for the determination of the reference system in the present case"*. Therefore, the Commission concluded that as Luxembourgish law did not draw any distinction between corporate taxpayers with respect to their geographical origin and *"since the profit of all corporate taxpayers is taxed in the same manner under the Luxembourg corporate income tax system* [...]*, all corporate taxpayers should be considered to be in a similar factual and legal situation"*.

Thirdly, the Commission assessed that since Luxemburgish tax law applied in an

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[99] According to the Decision, Art. 164(3) of the Luxemburgish *Loi des impôts sur le revenue* (LIR) is the provision concretizing the arm's length principle in the legal order of Luxembourg, providing that: *"Taxable income comprises hidden profit distributions. A hidden profit distribution arises in particular when a shareholder, a stockholder or an interested party receives either directly or indirectly benefits from a company or an association which he normally would not have received if he had not been a shareholder, a stockholder or an interested party."*.

equal way to all the market players generating profits in Luxembourg without any distinction between controlled and standalone companies, the ruling endorsing a different calculation methodology for the interested companies establishes an artificial differentiation fulfilling the requirement of selectivity under Art. 107(1) TFEU, as this had been justified on grounds of their nature of being member-firms of a group.

Fourthly, the Commission assessed that it was actually a purpose of the mentioned art. 164(3) LIR *"to align the tax treatment of transactions concluded between associated group companies with the tax treatment of transactions concluded between independent companies, so that the former are treated no more favourably than the latter under the Luxembourg corporate income tax system"* and that therefore the provision could not be used to confirm Amazon's positions and those of the tax administration.

Fifthly, the selective advantage granted to the endorsing tax ruling did indeed distort competition in the internal market. Indeed, *"since both types of companies are taxed on their total taxable profit at the same corporate income tax rate under the general Luxembourg corporate income tax system, any measure allowing the former to reduce its taxable base upon which that tax rate is applied grants it a favourable tax treatment in the form of a reduction of its corporate income tax liability as compared to the latter"*.

Sixthly and finally, the Commission highlighted that, on one hand, contrary to what *Amazon* and Luxembourg claimed the Commission never affirmed that *"the reference system must be limited to integrated companies only"* in its former Decisions and that, on the other hand, the Commission itself is not bound by its practice, for the only criteria which should be pursued when dealing State aid cases are those which are provided by Art. 107 TFEU, whose existence should be determined by the Commission itself through its own discretion.

Conclusively, the Commission fined Luxembourg with the obligation to recover *"the difference between what* [AEU] *paid in taxes and what it would have been liable to pay without the tax ruling"*.

SUMMARY AND CONCLUSION

In conclusion, this chapter analysed how the advent of the digital economy, in all its features, has changed the way of doing business.

The advent of the new economy and digitization allowed companies to enter foreign markets without having a real establishment or physical presence in the territory of the source country, since other completely innovative and mostly immaterial methods are used to operate and make profits in different countries compared to the country of residence.

The digital economy has accelerated and changed the spread of global value chains, in which multinational companies integrate their operations around the world. Advances in Information and Communication Technologies, the reduction of multiple customs and currency barriers, as well as the general shift to digital products and a service-based economy, combined with the desire to break down barriers to market entry, allow groups of multinationals to operate as global enterprises. As a result of this evolution, companies in all sectors are now able to design and build their operation around new technological capabilities, in order to improve flexibility and efficiency and extend their reach to global markets. However, this new set-up is not at all compatible with existing taxation systems. The new production process of making profits of the global enterprise, connected to the digitalization of the economy, sees what has been achieved in terms of profits not easily linked to the markets in which the enterprise operates and not easily attributable to a specific territory.

A topic of strong debate is the role of the permanent establishment in this new economic order, in fact, many aggressive tax planning schemes exercised by resorting to artificial transactions or arrangements have been highlighted, as they lack economic substance or are not consistent with functions and activities carried out. Electronic commerce has therefore introduced many changes and at the same time problems, including the elusive behaviour adopted by digital companies.

The latter, through a technical specification, the "Double Irish with Dutch Sandwich", have been able to evade and transfer their profits to countries with privileged

taxation. The organizational architectures put in place by companies to evade taxation, do not break the law but exploit obsolete rules and the limits of an uncoordinated international tax system, which also presents asymmetries between national tax systems.

This has led to the elaboration both within the OECD and the European Union of plans and rules designed to eliminate the erosion of tax bases and, above all, to a system aimed at a fair taxation of the profits deriving from the digital economy.

CHAPTER II

THE SOLUTIONS PROPOSED AT INTERNATIONAL LEVEL: THE POSITION OF THE OECD AND THE EUROPEAN UNION

SECTION 1

1. Framework

As we have seen in the previous chapter, the increasing digitalization of the economy has raised numerous tax issues. The progressive market affirmation of new business models, characterized by the intangible nature of the goods or services covered and the lack of any connection with the territory, has highlighted the inadequacy of the current tax system both at the international and national level.

International and national institutions have increasingly become aware that it is not possible to apply to the digital economy the fiscal discipline in force since the new digital system is not based on the same parameters as the economy and taxation used so far which are still closely linked to the requirements of space materiality and fixity.

The advent of the new economy has therefore reduced the significance of traditional concepts such as that of a permanent establishment which, characterized by the materiality of its elements and by the connection with a specific geographical place, is inappropriate when applied in relation to the digital multinational companies which carry out online operations, regardless of material elements linking a transaction to a given territory[100].

In order to tackle the problems arising from the continuous expansion of the digital economy and to avoid the evasive and elusive phenomena created by digital companies through aggressive tax planning, supranational bodies (primarily the OECD and the EU) launched a number of initiatives and actions to ensure a fair distribution of tax bases at international level.

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[100] Della Rovere A., Viola I., *Prospettive della digital economy in ambito internazionale, europeo e nazionale,* in *Il Fisco*, 10/2019, p. 947-949.

It is already since the 1990s that international organizations, particularly the OECD, have begun to examine the phenomenon of the digital economy and related tax problems. Reference is made in particular to three conferences organised by the OECD, one in Turku in 1997, one in Ottawa in 1998 and one in Paris in 1999, aimed at carrying out an initial analysis of the impact of the digital economy on the application of taxes and a reflection on the possibility of adapting traditional forms of taxation to new business activities carried out on the web or on the need to create special forms of taxation applicable only to online activities.

The guideline that emerged from these conferences and in particular that of Ottawa, was to adapt the current rules of traditional commerce to the characteristics of electronic commerce and more generally of the digital economy. A document entitled '"“*Electronic Commerce: Taxation Framework Conditions*” was then published by the OECD and considered that the traditional OECD taxation principles were applicable to the electronic commerce sector; in particular the principles of:

- neutrality: the tax system was intended to ensure homogeneous taxation between electronic commerce and traditional forms of trade, so as to apply the same levels of taxation to taxpayers operating under similar conditions. By safeguarding neutrality and fairness, economic choices motivated by economic expediency rather than purely fiscal considerations were favoured;
- efficiency: the costs of discharging taxpayer’s tax obligation and the administrative costs of tax authorities should not be made more onerous by the regulation of electronic commerce, but should be minimized as far as possible;
- certainty and simplicity: the tax rules had to be clear and easy to understand so that taxpayers could predict in advance the tax consequences of their transaction;
- effectiveness and fairness: tax discipline had to be concretely applicable in order to minimize evasion and avoidance, ensuring fair collection and distribution of taxes between States and applying law enforcement measures proportionate to the risks involved;

- flexibility: taxation systems had to be flexible and dynamic to ensure adaptation to commercial and technological developments[101].

The Paris Conference, finally, highlighted the need for a global intervention in the field of taxation of the digital economy and the importance of international dialogue in this field in the light of the particular characteristics of the new economy. This emerged by addressing the problem of locating income from commercial transactions carried out on the net: the theme was, in essence, that of the possible applicability of the concept of permanent establishment currently provided for in the OECD Model also in the context of electronic commerce[102].

It was thus entrusted to Working Party No. 1, sub-group of the Committee on Fiscal Affairs (CFA) of the OECD responsible for updating the Model Convention against Double Taxation, the task of reconciling the concept of a permanent establishment with the typical characteristics of the digital economy so as to allow its application in this context too. This activity ended in 2000 when the CFA approved the report entitled "Clarification on the application of the permanent establishment definition in e-commerce. Changes to the commentary on Article 5". This document did not involve any amendment of Article 5 of the OECD Model, but introduced ten new paragraphs 42.1 to 42.10 in its commentary.

The new paragraphs of the commentary addressed the question of the configurability or not of a permanent establishment in the presence of a website, a server or an Internet service provider in a State.

In essence, the new paragraphs analyse whether and under what conditions the presence in a State of a website, server or Internet service provider of a non-resident enterprise can be considered a sufficient condition for the existence of a permanent establishment of the enterprise itself[103].

On the basis of the information provided in the commentary, it appears that:

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[101] OECD, *Electronic Commerce: Taxation Framework Conditions,* 1998.

[102] Cassano G., Vaciago G., Scorza G., *Diritto dell'internet. Manuale operativo – casi, legislazione giurisprudenza,* Padova, CEDAM, 2012.

[103] Trutalli F., *Stabile organizzazione e commercio elettronico secondo il nuovo Commentario OCSE,* in *Bollettino Tributario*, 11/2001.

(i) a website cannot in any case be a permanent establishment because it is completely devoid of materiality; it is immaterial in nature because by definition, according to the same commentary, is a complex of software and computer data hosted in a server and accessible via the network without the need for machinery and it is not subject to localization[104]. The website therefore lacks the element of materiality, as it does not involve the use of property, machinery or equipment that can constitute a business location, and the element of fixity, as it has no specific location, for which it is wholly unsuitable for establishing a permanent establishment as it is defined in Article 5.1 of the OECD Model[105].

(ii) a server, that is the computer and the additional equipment necessary for the operation of the website, can be considered a permanent establishment. In fact, being endowed of a physical consistency, it possesses the requirement of the materiality and can therefore configure, under certain circumstances, a place of business.

The conditions to be fulfilled for a server to be considered a permanent establishment are three:

1. it must be established in a given territory and for a period sufficient to give it the character of fixity, both from a spatial and temporal point of view. From a spatial point of view, since a server can be identified as a geographic location, it does not detect the abstract ease of server movement as much as the fact that it is actually moved; as for the temporal profile, the server must be located in a certain place for a sufficient period of time not to assign it a precarious and temporary character;
2. it must be available to the undertaking holding the website installed[106]. The server is considered to be available to the enterprise only if it has the ownership or full availability of use; in other words, the non-resident who

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[104] OECD, *Commentary of Model Tax Convention on income and on capital,* 2014, Art. 5, par. 42.2.

[105] Corasaniti G., *Profili fiscali del commercio elettronico,* in *Diritto e Pratica Tributaria*, 1/2003, p. 616.

[106] OECD, *Commentary of Model Tax Convention on income and on capital,* 2014, Art. 5, par. 42.5, pp. 233-234.

carries out business activities must have the direct management of the server;

3. the enterprise must carry out, through the server, meaningful and essential functions for the development of the business, that they are not only auxiliary or preparatory to the same[107].

   The activities exercised through the server must be activities that constitute the core business of the enterprise, not limited to the only preparatory and auxiliary activities[108]. For example, they are considered ancillary or preparatory activities, which therefore exclude the configurability of a permanent establishment, the provision of a communication link between suppliers and customers, the advertising of goods and services, the transmission of information through a mirror server for security and efficiency, the collection of market information[109].

(iii) An Internet Service Provider (ISP), that is to say an entrepreneur who carries out web hosting activities (making a server available to other companies that carry out business activities through a website), except in exceptional cases, does not in itself constitute a permanent personal establishment of the enterprise which stores its website on the ISP server[110].

An ISP does not have the power, habitually exercisable, to conclude contracts in the name and on behalf of the non-resident undertaking. In any event, even if it had such power, the ISP could not assume the status of employee agent of the enterprise since it does not normally receive detailed and continuous instructions from the enterprise and because it hosts on its own servers the websites of several companies.

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[107] OECD, *Commentary of Model Tax Convention on income and on capital,* 2014, Art. 5, par. 42.7.

[108] Tomassini A., Tortora A., *Stabile organizzazione ed esterovestizione nel commercio elettronico,* in *Il Fisco,* 28/2006, p. 1-4334.

[109] OECD, *Commentary of Model Tax Convention on income and on capital,* 2014, Art. 5, par. 42.7.

[110] OECD, *Commentary of Model Tax Convention on income and on capital,* 2014, Art. 5, par. 42.10.

2. BEPS Project

Due to the constant growth and diffusion of the activities of the new economy, international and national interest in the taxation of the digital economy has become ever greater. In recent years, in particular, there has been an awareness of the need to adopt more effective and adequate fiscal measures. This requirement has been considered no longer to be procrastinated in the light of the increased importance of the digital economy in quantitative terms (consequence of the exponential growth of the web both in terms of diffusion on a global scale and in terms of employment for entrepreneurial purposes)[111], the different way of thinking about value creation (according to which it is the user's participation and the fact that he provides a data set that generates value for the digital enterprise) and lastly, increasingly aggressive tax planning, which leads to a significant erosion of the tax base by digital companies, by transferring profits to low or zero tax countries.

The development of the digital economy and the consequent challenges it has posed for national tax systems has therefore led to a necessary review of the principles contained in international treaties against double taxation and the introduction of measures to combat the elusive behaviour of digital multinationals.

Although the main contribution in this field has been provided by the OECD, through the elaboration of the BEPS Project, significant proposals in the field of taxation of wealth deriving from the digital economy have also been advanced by the European Union and also some national laws, including the Italian one, have launched new legislative initiatives.

In order to counter the aggressive tax planning strategies of multinational companies, in particular those operating in the digital economy sector, and to give a concrete and effective response to the challenges posed by the new economy, the OECD, under the political mandate of the G20 leaders, has developed the "*Base Erosion and*

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[111] Pedaccini F., *L'imposizione diretta nel contesto dell'economia digitale: stabili organizzazioni "virtuali", ritenute fiscali e la diverted profit tax,* in *Rivista Trimestrale di Diritto Tributario*, 4/2015, p. 3-4.

Profit Shifting" project (BEPS), the results of which provide national governments with a range of solutions to fill the gaps in existing tax systems and remedy the inadequacy of the existing tax system which has led to the income produced being able to erode the tax base.

Base Erosion and profit shifting (BEPS) means the set of strategies of fiscal nature that the enterprises put in place in order to subtract taxes to the tax authority, through the transfer of the profits (profit shifting) from high taxation countries to zero or reduced taxation countries[112].

These tax planning mechanisms are implemented through several factors:

- *(i)* aggressive fiscal strategies in high-innovation, digitalisation and globalisation contexts;
- *(ii)* inflexibility of tax systems in response to the extreme flexibility of corporate income;
- *(iii)* the possibility of separating taxation of income sources from the economic activities which generate it;
- *(iv)* lack of coordination and asymmetry between different national tax systems, for example in terms of differing tax treatment of the corporate balance sheet components (interest, dividends, etc.) and an uneven valuation of income items associated with intragroup and non-group transactions[113].

On 12 February 2013, the OECD published the Report "*Addressing Base Erosion and Profit Shifting*" (so called BEPS *Report*) which identifies the key principles of the taxation of cross-border activities and the problems of erosion of the tax base through the transfer of profits that they can create.

The Report shows that internationally accepted tax principles have not been able to adapt to recent changes in the different sectors of the economy and how multinational

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[112] Servizio del bilancio del Senato, *Il Progetto Base Erosion and Profit Shifting (BEPS),* in XVII legislatura, Nota breve n. 13, October 2015.

[113] Servizio del bilancio del Senato, *Il Progetto Base Erosion and Profit Shifting (BEPS),* in XVII legislatura, Nota breve n. 13, October 2015.

companies have increasingly exploited this inadequacy and differences between national tax systems to reduce income tax as much as possible[114].

The BEPS Report therefore suggested specific measures be taken to effectively combat the shift in profits and the consequent erosion of the tax base.

Consistent with what is suggested in the Report and to complete the indications contained therein, in July 2013 the OECD published the document "*Action Plan on Base Erosion and profit shifting*" (so called *Action Plan*) which identified the main actions that the various countries need to take to fight the BEPS phenomenon. The main principle of the *Action Plan* is to reduce the taxation of profits to the place where the economic activities are carried out and thus to the place where the value is actually created, so as to render ineffective the strategies of erosion of the tax base and displacement of profits.

The provisions of the *Action Plan* were incorporated in the G20 Declaration in St Petersburg (September 2013) in which the leaders of the twenty most advanced countries in the world have expressed their desire to promote actions to combat tax evasion and the phenomenon of aggressive tax planning and make effective the exchange of information between countries.

The *Action Plan* consists of 15 measures aimed at analysing and addressing internationally the phenomenon of tax base erosion and profit displacement; these measures are aimed in particular at realigning the principles of international taxation to the changed global environment and new organisational models of multinational companies which, by exploiting regulatory gaps and asymmetries between legal systems, can move profits to low-tax countries and pay less tax.

In essence, the 15 actions described in the Action Plan represent the interventions considered essential to achieve the aims of the BEPS project.

Action 2 to 14 are ideally divided into three main pillars:

1. the first pillar covers actions (2 to 5) which aim at giving coherence to national tax systems in the area of transnational activities;

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[114] Valente P., *Tax planning aggressivo. Il Rapporto OCSE "Addressing Base Erosion and Profit Shifting"*, in *Il Fisco*, 12/2013, pp. 5744-5745.

2. the second pillar concerns actions (6 to 10) which aim to reinforce the substantive requirements underlying existing international standards, pursuing the OECD objective of readjustment taxation with the substantial location of productive activities and value creation;
3. the third pillar includes actions (11 to 14) to increase transparency, exchange of information and improve Legal certainty[115].

For the purposes of our discussion we will focus only on two actions of the Action Plan, Action 1 on the digital economy and Action 7 on the definition of a new and more articulated concept of a permanent establishment. However, it is not necessary to analyse these actions individually, but it is necessary to consider them in the light of the entire Action Plan, since in order to achieve the objectives of the BEPS Project a joint and coordinated application of all measures is necessary, as they refer to each other in a continuous and transversal manner.

2.1 BEPS Action 1

The BEPS Project dedicates a whole action to the issue of taxation of the digital economy: Action 1, in fact, called "*The Tax Challenges of the Digital Economy*", addresses the tax issues generated by the development and affirmation of the new economy. It is not by chance that the OECD has dedicated just the first action of the Project to the digital economy. In fact, by virtue of the intrinsic characteristic of the new business models, the digital economy sector has been identified as the sector that is most sensitive to the phenomena of tax base erosion and profit shifting[116].

Action 1 builds on the observation that "*the digital economy is increasingly becoming the economy itself, so it would be difficult, if not impossible, to circumscribe the digital economy from the rest of the economy for tax reasons*"[117]. At the same time, it

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[115] Servizio del bilancio del Senato, *Il Progetto Base Erosion and Profit Shifting (BEPS)*, op.cit

[116] Rizzardi R., *La prima azione OCSE sul tema BEPS: la tassazione dell'economia digitale,* in *Corriere Tributario*, 20/2014, p. 1572-1576.

[117] OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report,* 5 October 2015.

is stressed that the digital economy and the new business models introduced by it, due to their specific characteristics, have increased the risks related to the erosion of the tax base, which would oblige the financial administrations of the various countries to find solutions compatible with the new structures in order to ensure fair and efficient taxation.

However, the current system of tax rules and procedures, both at national and international level, has not been able to effectively intercept the income generated by multinational companies operating in the digital sector and thus subject it entirely to taxation. The essential characteristics of the digital economy and related business models, analysed in the previous chapter, have made the traditional tax system outdated.

Among the initiatives identified in Action 1 to address emerging issues following the affirmation of the digital economy are included:

- the amendment of the list of exceptions allowing an enterprise, in the context of preparatory or ancillary activities, not to be qualified as a permanent establishment taking into account the particularities of the new business models;
- the introduction of new rules which, in relation to activities related to the digital environment, do not favour strategies of "fragmentation" such as to allow a company not to be qualified as a permanent establishment;
- revision of transfer pricing guidelines on the allocation of profits generated by the exploitation of intangible assets;
- the suggested CFC (Controlled Foreign Companies) endorsements to establish clear regulatory rules for foreign subsidiary[118].

The main problem that is faced by Action 1 is to understand whether or not there is a need to update the definition of a permanent establishment in the light of the innovations made by the digital economy. The concept of permanent establishment is considered a key element in determining the right to tax, but it is no longer suitable for its purpose with regard to the characteristic of the digital economy.

The mobility (which characterizes both the goods traded on the web, the users who participate in the transactions, and the localization of the operating functions of the

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[118] Romano C., Conti D., *La fiscalità della digital economy all'indomani degli studi BEPS,* in *Corriere Tributario*, 4/2016, pp. 301 ss.

enterprise) and the volatility of digital enterprises, enable them to avoid the configuration of a "taxable presence" in the territory of the State in which they operate, by ensuring that the concept of permanent establishment is no longer a valid criterion for linking income produced to taxation.

It is therefore the high degree of dematerialisation present in the digital economy and the possible fragmentation of functions, of risks and activities in the territory of more than one State that not only complicate the connection of an undertaking to a specific territory through a permanent establishment, but also impute to such a possible permanent establishment the correct taxable income.

For these reasons Action 1 has put forward a number of proposals to redefine the criteria for locating and determining the place where digital businesses produce income, in particular where such enterprises operate through new business models that allow them to limit or even cancel their physical presence in the territory through a completely dematerialized activity[119].

According to the OECD analysis, there is indeed a completely dematerialised activity when:

a) the core business of the enterprise is completely or for a considerable part, based on digital goods and services;
b) no physical element or activity is involved in the value chain except for the existence, use and maintenance of servers and websites or other IT tools suitable for data collection, processing and marketing;
c) contracts are concluded exclusively at a distance via the internet or by telephone;
d) payments are made exclusively through credit cards or other electronic means using online forms and platforms linked or integrated on the corresponding websites;
e) websites are the only means used to get in touch with the company;
f) there are no agencies for the execution of the activities compared to those of the parent company;

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[119] Melis G., *Economia digitale e imposizione indiretta: problemi di fondo e prospettive,* in *Diritto e Pratica Tributaria Internazionale*, 3/2016, p. 984-985.

g) most of the profits are attributable to the provision of digital goods and services;
h) the legal or fiscal residence and the physical location of the seller are ignored by the customer and do not influence his choices;
i) the effective use of the digital good or the provision of the digital service do not require the physical presence or involvement of a physical product other than the use of a computer or mobile devices or other computer tools[120].

Action 1 therefore proposed the creation of a new link criterion with a certain territory, irrespective of the presence of a taxable physical entity in the territory of the States in which digital companies are active. In this regard, it has been proposed to introduce the innovative concept of a "*significant economic presence*", which is considered to exist when specific conditions relating to revenues achieved on digital platforms or other IT tools are met.

In particular, according to the Action 1, there may be a significant economic presence (and, therefore, a permanent establishment legitimising the exercise of the power of taxation of the source State) if there are three main factors together, which are expressive of a constant and significant relationship that a foreign subject is able to establish with the economy of a particular country through technologies and other telematics instrument[121]. The manifestation of a significant economic presence of the foreign undertaking in that State would create such a connection as to make the profits generated therein taxable.

The three features on the base of which a meaningful economic presence can be configured are:

1. the income element: the achievement of revenues on digital platforms or other IT tools by clients of a particular State where the revenue exceeds a certain amount is considered fiscally relevant, provided that financial administrations are able to identify and measure distance sales;

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[120] OECD, Public Discussion Draft, *BEPS Action 1: address the tax challenges of the digital economy,* 24 March 2014.
[121] AA. VV., *Imprese multinazionali: aspetti societari e fiscali,* in Assonime, Note e Studi, 17/2016, p. 65.

2. digital elements: reference is made to the possibility of establishing interactions with customers in a given country through a local domain name, as a company aiming to sell products or services in a given country will create a local account, a local digital platform, through which the non-resident enterprise is in touch with customers by proposing its products on websites, in their own language and by studying local marketing, or the use of local forms of payment;
3. the user factor: it means every data and element that can be derived through the interaction with customers. We refer in particular to the so called "Monthly Active Users" (MAU), relating to the number of active users who usually visit the digital platform, the number of contracts concluded with local customers and the volume of data collected through a digital platform by users and customers habitually resident in a country for one year[122].

In any event, Action 1 did not provide for the effective implementation of the new linkage criterion, identified by the significant economic presence.

On the one hand, the transposition of these measures is expected to have a substantial impact on the various issues related to the digital economy. On the other hand, it is argued that the introduction of the new concept of significant economic presence would risk altering the balances that have been created over time in the distribution of entrepreneurial income between the State of the source and the State of residence.

2.2 Action 7

In October 2015, the OECD published the Final Report of BEPS Action 7 concerning changes to Art. 5 of the OECD Model governing the permanent establishment. This result has been achieved following the publication of two discussion drafts with which scholars of international law and representatives of governments were urged.

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[122] Salvini O., *La strategia anti-BEPS nell'economia digitale: la revisione del criterio di collegamento,* in *Rassegna Tributaria*, 3/2017, pp. 768 ss.

The objective which the OECD was seeking to achieve through the preparation of Action 7 was to change the definition of a permanent establishment contained in the Double Taxation Conventions, as it was not considered appropriate, in the light of the advent of the digital economy, to ensure a "*fair allocation of taxing rights of business profits*"[123].

The amendments to Art. 5 of the OECD Model are multiple and covered several aspects.

First of all, Action 7 of the OECD was concerned with the new wording of Article 5 of the OECD Model with particular reference to the "permanent personal establishment", since the previous version of the article allowed the figure of the *commissioner* to escape the "type" of such criterion of, even in the presence of an agent who would have concretely contributed to the regular conclusion of contracts with the clients of the non-resident enterprise.

The focus was placed on the term "conclusion of contracts" for the existence of the permanent personal establishment (so called *artificial avoidance of PE status through commissionaire arrangements and similar strategies*). This intervention was driven by the finding that in recent years the subject of *commissioner* has been the subject of many disputes, due to the frequent arguments of the tax authorities about the configurability, in the territory of the State of a permanent personal establishment.

Before the Action 7 intervened, the position of the *commissioner* had never been clear, compared to the expression "*conclude contracts in the name of the enterprise*", used in Art. 5 of the OECD Model and in the Conventions. The question arises, from the debate about the "legal" or "economic" constraint which should bind the foreign

[123] According to Action 7 of BEPS Project: "*The definition of permanent establishment (PE) must be updated to prevent Abuses. In many countries, the interpretation of the treaty rules on agency-PE allows contracts for the sale of goods belonging to a foreign enterprise to be negotiated and concluded in a country by the sales force of a local subsidiary of that foreign country without the profits from these sales being taxable to the same extent as they would be if the sales were made by the distributor.*

In many cases, this had led enterprises to replace arrangements under which the local subsidiary traditionally acted as a distributor by 'commissionaire arrangements' with a resulting shift of profits out of the country where the sales take place without a substantive change in the functions performed in that country. Similarly, MNEs may artificially fragment their operations among multiple group entities to qualify for the exceptions to PE status for preparatory and ancillary activities".

enterprise and its intermediary to consider integrated the hypothesis of the personal permanent establishment. The interpretation of the above mentioned phrase declined differently depending on the origin of the subjects who were called to analyse the norm.

In fact, in *common law* countries, it is always integrated the case of the permanent personal establishment with the exception of the hypothesis in which the agent is independent from the non-resident enterprise. Basically, in *common law* countries it is irrelevant whether the representation is direct or indirect, which is why, if an agency relationship were established, the agent would always legally bind his principal.

On the contrary, in *civil law* countries, such as Italy, acting on behalf of the principal is linked to the power of representation, "direct" or "indirect", and with it to the legally binding relationship that connect the third party subject to the sender. Therefore, to bind the principal, the agent must spend his name: he must act in the name and on behalf of his principal.

The aim of Action 7 was to clarify the correct interpretation of paragraphs 5 and 6 of Art. 5 of the OECD Model:

- on one hand, paragraph 5 of the OECD Model identifies the existence of a permanent establishment if the non-resident enterprise acts through an agent who habitually concludes "contracts in the name of enterprise", without prejudice to ancillary activities;
- on the other hand, paragraph 6 makes an exception by stating that the conditions for establishing a permanent personal establishment in the territory of the State have not been met, if the agent has an independent status and acts in the ordinary course of business.

Therefore, it has been clarified that there may be a permanent personal establishment regardless of whether such contracts are concluded by the agent on behalf of the non-resident undertaking, when that agent plays a decisive role in the conclusion of the contracts, which are systematically perfected by the foreign company without any substantial change. In fact, the new text of paragraph 5 of Art. 5 speaks of "*the principal role leading to the conclusion of contracts*".

In order to understand the presence or not of such situation, it will be necessary to investigate the contractual formulas proposed and, in particular, the arrangements for remuneration of the commissioner. An appropriate indicator of the decisive role of the agent in the conclusion of the contracts is certainly the fact that its remuneration is proportional to the turnover of the foreign company[124].

On the other hand, advertising activities and other promotional activities should be excluded from the possibility of incorporating the idea of a permanent establishment[125]. Likewise, the OECD has specified that the mere participation of the agent in the negotiation phase does not incorporate the condition of having played a decisive role in the conclusion of the contracts[126].

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[124] Paragraph 32.6 of the Final Report states: "*The following is another example that illustrates the application of paragraph 5. RCO, a company resident of State R, distributes various products and services worldwide through its websites. SCO, a company resident of State S, is a wholly-owned subsidiary of RCO. SCO's employees send emails, make telephone calls to, or visit large organisations in order to convince them to buy RCO's products and services and are therefore responsible for large accounts in State S; SCO's employees, whose remuneration is partially based on the revenues derived by RCO from the holders of these accounts, use their relationship building skills to try to anticipate the needs of these account holders and to convince them to acquire the products and services offered by RCO. When one of these account holders is persuaded by an employee of SCO to purchase a given quantity of goods or services, the employee indicates the price that will be payable for that quantity, indicates that a contract must be concluded online with RCO before the goods or services can be provided by RCO and explains the standard terms of RCO's contracts, including the fixed price structure used by RCO, which the employee is not authorised to modify. The account holder subsequently concludes that contract online for the quantity discussed with SCO's employee and in accordance with the price structure presented by that employee. In this example, SCO's employees play the principal role leading to the conclusion of the contract between the account holder and RCO and such contracts are routinely concluded without material modification by the enterprise. The fact that SCO's employees cannot vary the terms of the contracts does not mean that the conclusion of the contracts is not the direct result of the activities that they perform on behalf of the enterprise, convincing the account holder to accept these standard terms being the crucial element leading to the conclusion of the contracts between the account holder and RCO".*

[125]Ferroni B., *Stabile organizzazione: la disciplina nazionale si adegua al BEPS e introduce la "continuativa presenza economica"*, in "*Il Fisco*", 7/2018, p. 1-632.

[126] Paragraph 33 of the Final Report states: "*The requirement that an agent must "habitually" conclude contracts or play the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise reflects the underlying principle in Article 5 that the presence which an enterprise maintains in a Contracting State should be more than merely transitory if the enterprise is to be regarded as maintaining a permanent establishment, and thus a taxable presence, in that State. The extent and frequency of activity necessary to conclude that the agent is habitually concluding contracts or playing the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise will depend on the nature of the contracts and the business of the principal. It is not possible to lay down a precise frequency test. Nonetheless, the same sorts of factors considered in paragraph 6 would be relevant in making that determination".*

The Action 7 also proposes to modify the concept of independent agent referred to in Art. 5, paragraph 6 of the OECD Model, by tightening the conditions for the existence of the requirement of the agent's independence, which, if integrated, would remove the "permanent personal establishment"[127].

For these particular purposes, the independence of the intermediary should be appreciated, both from a legal point of view and taking into account the "economic" profile: the higher the number of clients, the more likely it is that the agent is actually financially independent. However, this factor is not in itself sufficient to indicate the economic independence of the agent, since the characteristics of the agent's activity and the associated risks are also relevant. For example, the expectation of a fixed remuneration or the guarantee granted by the principal or the coverage of any losses suffered by the intermediary, are indicators of the lack of independence of the intermediary.

It should be pointed out that the first outline of discussion Draft previewed that the agent would have been to be qualified as dependent from the foreign enterprise if it had operated exclusively for a single principal or for the enterprises of a same group. The OECD Final Report subsequently modified this approach, merely to foresee that this would be considered a sufficient indicator for the disappearance of independence (the new paragraph 6 of Art. 5 of the OECD Model refers to "*enterprises to which is closely related* ").

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[127] Action 7 – prevent the artificial avoidance of PE status, p. 16: *"a) Paragraph 5 shall not apply where the person acting in a Contracting State on behalf of an enterprise of the other Contracting State carries on business in the first-mentioned State as an independent agent and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise. b) For the purposes of this Article, a person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise".*

With regard to the amendments approved in respect of activities, "preparatory" or "auxiliary" (*artificial avoidance of PE status through the specific activity exemptions*), paragraph 4 of Art. 5 of the OECD Model identifies the hypotheses in which, although all the elements integrating the concept of permanent establishment are present, it must be assumed that this does not exist.

Reference is being made to those cases which constitute the so called "*negative list*". The latter, reduces the scope of the concept of permanent establishment by removing relevance, for the purposes of the "business activity test", to some actions of the enterprise: the preparatory or ancillary activities.

Under the BEPS project, the "*negative list*" is the subject of two interventions introducing the need to carry out a case-by-case analysis in order to determine whether the presence of the foreign company in the territory of the State integrates the condition of the permanent establishment.

The first intervention concerns paragraph 4 of Art. 5 of the OECD Model and is intended to establish that, for the purposes of the exemption, the preparatory or auxiliary nature of the activity must be assessed on a case by case basis taking into account:

- the general purpose of the enterprise[128];
- activities other than preparatory or ancillary activities carried out in the enterprise "fixed place of business" (criterion of the other activities)[129];
- the recipient of the activity itself (criterion of the recipient);
- the character of the activity itself (criterion of the activity), which in particular:

[128] Paragraph 21.1 Action 7 states "*It is often difficult to distinguish between activities which have a preparatory or auxiliary character and those which have not. The decisive criterion is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole. Each individual case will have to be examined on its own merits. In any case, a fixed place of business whose general purpose is one which is identical to the general purpose of the whole enterprise, does not exercise a preparatory or auxiliary activity*".

[129] Paragraph 30 Action 7: "*Where paragraph 4 does not apply because a fixed place of business used by an enterprise for activities that are listed in that is also used for other activities that go beyond what is preparatory or auxiliary, that place of business constitutes a single permanent establishment of the enterprise and the profits attributable to the permanent establishment with respect to both types of activities may be taxed in the State where that permanent establishment is situated*".

i) it must not be the essential and significant of the enterprise as a whole (criterion of the essential and significant activity);
ii) must precede it, generally lasting for a short period of time (criterion of preparatory activity):
iii) must support it, without being part of it and without requiring a significant part of the company's assets or employees (criterion of the ancillary activity).

The second intervention, however, concerns the introduction of the so called "*anti-fragmentation rule*" in the new paragraph 4.1 of Art. 5 of the Model ("*a new anti-fragmentation rule was introduced to ensure that it is not possible to benefit from these exceptions through the fragmentation of business activities among closely related enterprises*").

This second intervention, in addition to being the most innovative, interferes with one of the cornerstones of international taxation: the so called "*separate entity approach*" according to which each entity, although belonging to a group, must be treated separately. Therefore, the exclusion provided for in paragraph 4 of Art. 5 is not applied where the activity as a whole considered to be the understanding of such entities is not preparatory or ancillary and is part of a larger unit complex of business operations.

With this provision, the OECD sought to strengthen the tax power of the source State by reducing the effectiveness of the strategies implemented by multinational groups, with the aim of taking over markets without constituting a taxable presence, that is, without incorporating the conditions of the permanent establishment.

In light of the new *anti-fragmentation rule*, the commentary to Art. 5 of the OECD Model has been modified and added as well as numerous examples of activities that have a preparatory or auxiliary character, a new ad hoc section dedicated to the new paragraph 4.1.

The amendments of Art. 5 as a result of the need to analyse the activities on a case-by-case basis, has undoubtedly led to a strengthening of the fiscal power of the source State consequently to the restrictions on exemption and the extension of the concept of permanent establishment.

3. Tax Challenges Arising from Digitalisation - Interim Report 2018

In March 2017, the G20 gave a mandate to the Task Force on the Digital Economy (TFDE) to develop an interim report on the implications of the digitalisation of the tax-laden economy and a final report in 2020. The first report, called "*Tax challenges Arising from Digitalisation*", was approved by all members of the Inclusive Framework and was published on March 16, 2018.

The OECD Intermediate Report represents an additional element in the work carried out in 2015 with the Final Report for the BEPS Project.

The aim is to establish a direction of work, until 2020, on the determination of the correct tax rules on the digital economy and to provide tax authorities with new tools to improve the efficiency of tax collection and detection of tax evasion.

The document provides an in-depth analysis of how different types of businesses are able to create value, with a specific focus on digital markets. Later, it describes the progress achieved between 2015 and 2018, in the implementation of the BEPS package, specifically analysing the impact that the BEPS has had on the behaviour of highly digitised companies.

The OECD's interim report highlights how technological evolution has led to a rapid decline in data processing costs, thus facilitating the integration of digital products and a structural transformation of the economy. The structure of enterprises and value creation processes have evolved significantly and features common to many digital enterprises have emerged: first, "the achievement of a scale without mass"[130]; second, the high meaning of intangible assets, especially intellectual property and investments in the same sector for the development of algorithms to support the platforms and websites used, third, the importance of data collection and analysis.

The document also proposes temporary measures to be implemented to address the challenge posed by the digital economy: since a full and unanimous decision in the

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[130] The term refers to the possibility, especially for the "HDBs" (Highly Digitalized Businesses), to be present in the economy of a country without any significant physical presence (TPA Global (2019), *OECD Releases Digital Economy Taxation Interim Report,* 19 March).

long term will still take a long time, short-term solutions are allowed, but with specific limits. It has been pointed out that there has been no consensus among some of the OECD Member States on the need for, or substance of, interim measures, so the report does not serve the purpose of recommending the introduction of the envisaged measures. The reasons for which many countries do not perceive the urgency of measures to combat the circumventions deriving from the digital economy are also underlined and mainly consist in the fear of negative consequences on various aspects of the economic life of the State: the impact on investment for innovation and growth; the impact on the well-being of the population, due to a likely distortion of production, and finally the potential impact on consumers and businesses, given the possibility of price increases and the increase in administrative costs, which could outweigh the benefits obtained.

Temporary measures that can be taken must, therefore, meet a number of requirements, such as compliance with a State's international obligations, temporary nature, specificity, minimization of over-taxation, and (negative) impact on start-ups and small businesses and that of the costs and complexity of execution[131].

The 2018 report concludes, with the forecast of an update in 2019, which in fact happens with the consultation Document and the Policy Notes, analysed below, as well as the agreement of Member States to review the impact of digitisation on profit allocation and allocation rules and to commit to continue working together towards a final report in 2020, aiming at providing a long-term solution, with the consent of all.

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[131] OECD/G20 (2018), *Tax Challenges Arising from Digitalisation – Interim Report,* Base Erosion and Profit Shifting Project.

Section 2

1. Taxation of the Digital Economy at EU Level

The digital economy, due to its strong influence on the evolution of business models, is putting the international tax system to the test; policy-makers have been finding it very difficult for several years to find a solution that ensures fair and effective taxation. The European Union is trying to tackle this problem autonomously, waiting for the final and complex international solution that the OECD, in harmony with the G20, has been trying to find for some time.

Recognition of the need for action at European level to address the challenges of digitalisation has also occurred earlier, in the May 2015 Communication, in which the strategy for the creation of a single European digital market is determined, and in two proposals for 2016 directives, CCTB and CCCTB, which seek to determine a common tax base (and common consolidated tax base) for corporate taxes.

In the Commission Communication entitled "*A fair and effective tax system in the European Union for the digital single market*" adopted on 21 September 2017, the fiscal challenges posed by the digitalisation of the economy are analysed. The document acts as a starting point for the interventions of the European Council, at its meeting of 19 October 2017, and of the ECOFIN Council.

A few days before the issuance of the September 2017 Communication, the Ministers for Economic Affairs of Italy, France, Germany and Spain signed a joint declaration to reach a satisfactory solution regarding the taxation of digital enterprises at European level. The declaration was discussed on 16 September at the informal ECOFIN in Tallinn. For the first time a joint political declaration is proposed at European level for the digital economy, which strongly emphasises the recognition of the urgency of a fair and efficient tax system[132].

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[132] Marè, M. (2017), *Web tax, perché l'India è il modello da seguire*, Il Sole 24 Ore, 17 settembre.

This has led to the two Directive proposals of 2018, numbers 147 and 148. The first one illustrates the economic context that has arisen in recent years with the development of the digital economy and explains why the current regulatory framework is not sufficient to ensure proper taxation, rather focusing on the determination of a significant digital presence. The second one proposes a system of Community taxation applicable to the revenues of digital companies.

The proposals show not negligible critical aspects: the fact that the tax only affects certain activities could lead to distortions and create uncertainty; secondly, criticism has been levelled at the ability to locate users via IP addresses, since these are often mobile and do not always refer to the state in which the user is actually located; finally, both proposals are based on qualitative definitions, such as "digital services" or "digital interface".

But the European fiscal process seems to have stalled momentarily, causing an increase in unilateral action by Member States. Indeed, at the ECOFIN Council of 12 March 2019, it proved impossible to reach a Community agreement, which would necessarily have to be unanimous, because of the opposition of some Member States. Europe is therefore awaiting the developments arising from the OECD/G20, but is ready to try again to introduce a Community solution in the event that a conclusion is not reached by 2020. Competition Commissioner Margrethe Vestager said that "if there was no global consensus, Europe would have to make progress"[133], confirming, however, that, as mentioned, the best solution for a fair taxation of the digital economy remains the international one.

1.1 The European Digital Single Market

[133] Europarl.europa.eu. *HEARING OF MARGRETHE VESTAGER EXECUTIVE VICE-PRESIDENT-DESIGNATE OF THE EUROPEAN COMMISSION*. [online] Available at:<https://www.europarl.europa.eu/resources/library/media/20191009RES63801/20191009RES63801.pdf> [Accessed 15 March 2020].

At the summit on the digital economy in Tallinn on 29 September 2017, the European Commission produced a progress report on the strategy for the *digital single market*. The document begins by illustrating the three pillars of the strategy and the relative points in which they are articulated.

In this document, it is explained how the technologies of information and communication are by now the foundation of all the modern economic systems and how they are carrying out a fast change in the business models, that can give rise to many possibilities of innovation, growth and employment, but also very complicated problems that public administrations must be able to cope with. The best way to tackle these challenges, is to use a Community-based approach, with coordinated action, given that the individual Member States are too small to grasp all the opportunities and solve all the problems.

The *digital single market* is defined as a market in which the free movement of goods, persons, services and capital is ensured and in which, irrespective of their nationality, or place of residence, persons and businesses do not encounter obstacles to access and use online activities, in conditions of fair competition and being able to rely on the protection of consumers and personal data.

The strategy for the creation of the single market set out in the Communication is based on three pillars: improving online access to goods and services across Europe for consumers and businesses, with the consequent elimination of differences between the online and offline world, in order to break down barriers to cross-border activity; create a favourable environment for digital networks and services to develop, for which high-speed infrastructure and services are needed, supported by favourable conditions for innovation; maximising the growth potential of the European digital economy, which implies high investment in ICT infrastructures and technologies.

In order to ensure the most efficient creation of the market, it is necessary, according to the document, to take immediate action to eliminate differences in contract law and copyright law between the Member States. It is also necessary to prevent unjustified “geoblocks”, that is to say, practices by online sellers, for commercial reasons, which prevent the consumer from accessing websites based in other Member States or

which, while allowing access to the platform, do not make it possible to purchase the available goods.

Since 2015, considerable measures have been taken to create the *digital single market*. On 24 May 2015, the general regulation on data protection, which is the legal basis for the protection of personal information, comes into force, already recognised by the Treaty of Lisbon as a fundamental right of the EU; from 15 June 2017, roaming charges will no longer apply in the European Union; on 14 February 2019, a provisional agreement for the reform of copyright law is signed, and on 15 April of the same year a directive on the same subject was adopted[134].

2. EU Directive Proposal COM (2018) 147 *Final* Significant Digital Presence (SDP)

The basis on which the proposal for a directive is based is substantially the same as that of Action 1 of the BEPS project, that is the awareness that digital companies can disregard the physical presence in a given jurisdiction and therefore the traditional criteria of connection are insufficient. Hence the attempt to create a new nexus that allows taxation in the country where value is actually created.

The proposal for a Directive, therefore, does not provide for the introduction of a specific tax, but the application of corporate taxes already provided for by individual Member States and takes up the concept of a significant digital presence and a virtual permanent establishment. The latter in particular would not replace the traditional concept of permanent establishment but would integrate it.

Therefore, where profits cannot be localized in a particular country, since there is no classical presence of a permanent establishment (physical presence), the digital nexus aimed at identifying the virtual permanent establishment would operate as an additional criterion[135].

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[134] European Council (2019), Digital Single Market in Europe.

[135] HONGLER P. – PISTONE P., *Blueprints for a New PE Nexus to Tax Business Income in the Era of Digital Economy,* in IBFD *White Paper,* January 2015, pp. 23 ss.

The first problem addressed by the proposal for a directive is to identify the *quid* that would characterise digital companies as being different from traditional commercial enterprises, as well as understanding what is the instrument through which they carry out their activities. From this derives the notion of "digital services", which would be the typical and characteristic services of digital enterprises, and digital interface.

Article 3 defines the concept of "digital interface" as any software, including the websites or some of them and its possible applications, also mobile, accessible to users; then, that of digital service. It is a service provided via the internet or through an electronic network, whose nature makes its supply essentially automatic, such as to require the least human intervention. These include, in particular, the provision of digital products, including software, their modifications and updates; services that convey or support the presence of a company or a private individual on an electronic network; services automatically generated by a computer via the internet or an electronic network; the granting, for consideration, of the right to sell a good or service on an online market website, where potential purchasers make bids through an automated process and flat-rate offers of Internet service packages (ISPs) and the telecommunication component is an ancillary and subordinate element.

The simple sale of goods and services, facilitated by the use of the internet or an electronic network, is not considered a digital service. The slightest human intervention is required not only on the supply side but, of course, also on the demand side, that is the users of the service.

Thus circumscribed the activities of digital companies, the proposed Directive defined the concept of "significant digital presence", or digital presence.
The latter is found when in a Member State, during a tax period, the activity carried out consists wholly or partly in the provision of digital services through a digital interface (Art. 4), where the minimum thresholds are integrated[136].

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[136] A significant digital presence, according to the proposal, it would be identifiable if a digital enterprise is characterised by the following values, valid for a tax period:

- revenues from the provision of digital services exceeding EUR 7 million,
- number of users exceeding 100,000 or

Once the concept of digital presence was defined, however, there was a further problem of identifying the criteria for allocating profits to the virtual organization.

Although the Commission noted that the criterion used for profit-sharing within corporate groups operating in different countries is transfer pricing, it considered that this criterion was not appropriate to the characteristics of digital enterprises and how they create value.

This is because the intangible assets take on such enterprises, such as user data and data analysis methods to extract value from them. The Commission therefore considered it appropriate to look for a different criterion that would allow the valuation of intangible assets and determine their contribution to value creation within a group.

Despite this, the Commission then considered that the most suitable criterion was still the one of "functional" type and that is a criterion that attributed the profits to the virtual permanent establishment based on the functions carried out by this, making an analysis of comparative type.

The solution was therefore to give digital presence the profits it would make through certain relevant economic activities carried out through a digital interface, in particular in its relations with other parts of the company, considering the virtual permanent establishment as if it had been a separate and independent undertaking engaged in similar or identical activities under similar conditions. The criterion envisaged is the one traditionally used in the OECD (based on the arm's length principle and comparability analysis).

However, the Commission, taking into account the way value is created in digital activities, considered that what is most relevant in the functional analysis for the attribution of profits to the digital presence are the activities (and not persons) carried out by the enterprise through a digital interface in relation to data and users. It is therefore the activities carried out that identify the "economically relevant functions" that should be considered for the attribution of the economic property of the assets and the risks of the significant digital presence. As a result, the Commission considered that for profit

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- commercial contracts for digital services exceeding 3000.

allocation, the five key activities identified in the OECD guidelines are relevant. These are: the development, enhancement, maintenance, protection and exploitation of intangible assets in the exercise of economically relevant activities by the digital presence, even if they are not linked to staff duties in the same Member State. Therefore, the five activities were considered as typical of a "significant digital presence", regardless of the weight that the person element could take.

The Commission concluded that the most reliable criterion for the allocation of profits to a virtual permanent establishment should be the profit split method which is one of the criteria for profit-sharing in controlled transactions between related companies in OECD guidelines on transfer pricing[137]. It must also be said, however, that alternative provision has been made for the possibility of using a different method which is considered more appropriate in accordance to the results of the functional analysis.

2.1 Most significant features of the Directive Proposal

In its draft titled "Taxation of Digital Activities in the Single Market", dated 26 February 2018 and in the proposals put forward on 22 March 2018[138], the European Commission evolved in line with the OECD Interim Report published on 16 March 2018. Now, the Commission restricts the digital tax relevance of the place where sales take place, to the cases where the consumer of digital services or products contributes to value creation (*i.e.* to the digital company's profits). The mismatch between 'value creation' and 'the place where taxation takes place' allegedly results from the combination of the

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[137] These comments have been incorporated into Article 5 of the proposed Directive, which in the second paragraph provides that the profits to be attributed to the virtual permanent establishment are those which it would have achieved if it had been a separate and independent undertaking carrying out identical or similar activities, under similar or identical conditions. The allocation of profits is based on a functional analysis and to determine the functions of the virtual permanent establishment account must be taken of the economically relevant activities carried out through a digital interface. The relevant activities attribute the risks and economic ownership of the assets to the digital presence.

[138] European Commission, Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services

three factors identified in the OECD Interim Report, namely scale without mass; reliance on IP; and user value creation[139].

In the context of the Inclusive Framework and the OECD Interim Report, the European Union belongs to the group of jurisdictions that supports 'user value creation' as legitimizing taxation in the user country.

User value creation is relevant to identify a digital permanent establishment, but to a lesser extent than in the case of the equalization levy. The concept of a digital permanent establishment as proposed by the Commission interprets user value creation according to the intensity of the digital presence in the market country, without introducing a group size threshold, and covers smaller business with a large digital footprint in a market Member State[140].

Moreover, according to Article 5 paragraph 5, letter *c*) of the proposal, a digital permanent establishment can supply any type of digital service.

The proposal therefore follows the traditional idea that a permanent establishment requires a minimum period of permanence in the source State[141] (in the case of the digital permanent establishment without physical presence).

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[139] See European Commission, Taxation of Digital Activities in the Single Market, draft (26 Feb. 2018), https://www.politico.eu/wp-content/uploads/2018/02/taxation-of-digital- economy-2.pdf European Commission, Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services, Brussels, 21 March 2018 COM (2018) 148 final 2018/0073 (CNS), https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_common_system_digital_services_tax_21032018_en.pdf European Commission, Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence, Brussels, 21 Mar. 2018 COM (2018) 147 final 2018/0072 (CNS),https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_significant_digital_presence_21032018_en.pdf.

[140] European Commission, Taxation of Digital Activities in the Single Market, para. 2.5; Art. 4, para. 3, European Commission, Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence.

[141] The OECD seriously consider using a minimum time period for which an activity has to be performed in a continuous manner before a PE is created. The 183-day rule of Art. 15, MTC uses the concept of a time frame with great success and, notably, with a minimum amount of controversy associated in defining the scope of this definition. Art. 5, par. 3, MTC could be used as a precedent to establish a twelve-month period as the minimum duration for a foreign enterprise's activities to rise to the level of PE. This can be derived from the fact that the construction and installation projects often require a substantial physical presence so that other businesses with less physical presence should, at the very least, also enjoy a twelve-month de minimum rule. A prescribed time frame allows businesses and tax authorities to assess, in advance, whether or not a PE will emerge. Oecd.org. 2013. *OECD Model Tax Convention: Revised Proposals Concerning*

According to Article 4 paragraph 3 of the Proposal, a 'significant digital presence' shall be considered to exist in a Member State in a tax period if the business carried on through it consists wholly or partly of the supply of digital services through a digital interface and one or more of the following conditions is met with respect to the supply of those services by the entity carrying on that business, taken together with the supply of any such services through a digital interface by each of that entity's associated enterprises in aggregate: (1) the proportion of total revenues obtained in that tax period and resulting from the supply of those digital services to users located in that Member State in that tax period exceeds EUR 7,000,000; (2) the number of users of one or more of those digital services who are located in that Member State in that tax period exceeds 100,000; (3) the number of business contracts for the supply of any such digital service that are concluded in that tax period by users located in that Member State exceeds 3,000.

In turn, the targeted solution consists of an equalization levy on the gross revenues of a digital business characterized by user value creation[142]. It aims to prevent the adoption of unilateral measures while the long term solution is being discussed.

The proposed tax is to be levied on gross revenues, with no deduction of costs, where digital activities incorporate user value creation. Because a targeted measure is temporary, it should cover the business models where the mismatch between taxation of profits and value creation is more acute.

Indeed, the emphasis on user value creation led the Commission to propose a tax on services supplied for consideration consisting in the monetization of user data, by making available advertisement space (*i.e.* Facebook, Google, AdWords, Twitter) or the sale of such user data and on services supplied for consideration by making available digital platforms or marketplaces to users and where such users supply goods and/or services directly between themselves (*i.e.* Airbnb, Uber).

Moreover, the tax would apply only if the business is above an annual worldwide total revenue of EUR 750 million (at the level of the multinational group; and the annual

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the Interpretation and Application of Article 5 (Permanent Establishment). [online] Available at: <http://www.oecd.org/ctp/treaties/PermanentEstablishment.pdf> [Accessed 3 April 2020].

[142] European Commission, Taxation of Digital Activities in the Single Market, para. 3.3.

revenue from the provision of digital services in the EU is between EUR 10 and 20 million). The tax would apply to both cross-border transactions and domestically, in order to be compliant with international obligations.

3. Directive Proposal 148/2018: Digital Service Tax (DST)

The proposal for a Directive COM (2018) 148 final, which should be temporary in scope (pending the implementation of Directive 147), provides for the establishment of a specific tax which is called "Digital Service Tax".

The premises are basically identical to the proposed Directive 147, with the need to realign value and jurisdiction in the digital sector. The aim of the committee is also to standardise the different web taxes in order to avoid fragmentation and fiscal asymmetries between the different States, whereas several Member States have already taken diversified unilateral measures to solve the problem of digital taxation.

The Directive Proposal is based on Article 113 of TFEU[143], on the "harmonisation" of Member States' legislation on other indirect taxes. It follows that DST, although referring to the number of revenues generated in a Member State on the

[143] It might be noted in passing that there is an intense discussion as to the correct legal basis of the DST proposal, i.e. whether it should be based on Art. 113 TFEU or on Art. 115 TFEU (see para. 8 in the Note from the Presidency to the Permanent Representatives Committee/Council, supra n. 42, which largely depends on how to understand the terms 'turnover taxes' and 'other forms of indirect taxation' in the former provision. Since the DST Proposal aims at the issuance of a Directive (the only instrument available under Art. 115 TFEU) and both provisions would trigger the same legislative procedure, the choice of legal basis might not have any immediate legal ramification, although it remains to be seen how the ECJ will address that issue. The Court has the authority to review Union acts for the lack of competence or the choice of the wrong legal basis, ruling on the 'legality' or 'validity' of legislative acts (Arts 264 and 267 TFEU). The issue of 'legality' includes, under Art. 263 TFEU, 'jurisdiction in actions brought by a Member State, the European Parliament, the Council or the Commission on grounds of lack of competence' and to declare such acts 'void' (Art. 264 TFEU), but a temporal limit is put on such proceeding, as those 'shall be instituted within two months of the publication of the measure' (after which elapse the lawfulness of the Union act is presumed; see e.g. GR: ECJ, 5 Oct. 2004, Case C-475/01, Commission/Greece ('Ouzo'), EU:C:2004:585, paras 22–23). No such temporal limit is imposed on preliminary ruling procedures initiated by domestic courts under Art. 267 TFEU, where the ECJ reviews the 'validity' 'of acts of the institutions, bodies, offices or agencies of the Union', which may include lack of competence; such a finding by the ECJ, though only addressed to the referring national court, has quite similar effects as an annulment in a procedure under Art. 263 TFEU (see e.g. IT: ECJ, 13 May 1981, Case C-66/80, SpA International Chemical Corporation, EU:C:1981:102).

basis of the significant role users play in value creation, it cannot be considered as an income tax, but is an indirect tax on value creation.

The proposed DST is a destination-based turnover tax levied on gross revenues net of VAT (and other similar taxes) arising out of certain digital services. Costs cannot be deducted from the tax base and losses cannot be carried forward. The rate, in turn, is set at 3%, to achieve an appropriate balance between revenues generated by the tax and to account for the differential DST impact for businesses with different profit margins.

DST-taxable persons will be any corporate or transparent entity fulfilling two conditions.

The first condition, whose objective is to exclude small to medium enterprises and start-ups and, thus, to only target companies of a certain scale able to establish strong market positions, requires the entity to have a total amount of taxable revenues in the relevant financial year that exceeds EUR 750 million. The second condition, whose objective is to capture only those entities with a 'significant digital footprint' in the EU requires the entity to have a total amount of taxable revenues obtained within the EU that exceeds EUR 50 million[144]. The first threshold limits the number of taxpayers by limiting the tax to large organisations based on network effects and the exploitation of big data[145]. The choice of this group of taxpayers responds to two aims: firstly, to consider the ability of these companies to contribute as an indicator of their ability to attract a large number of users; on the other hand, the willingness to highlight their tendency to aggressive tax planning and abuse of law. The second threshold, the amount of the EU's taxable annual revenue, serves to limit the application of the tax to cases where there is a "significant fingerprint" in European territory.

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[144] Art. 4(1)(b). These amounts are calculated at the date of when they fall due, not when they are effectively paid/received, see Art. 4(5) 2018 DST Directive Proposal. The text of the proposal is however not entirely clear on whether the first bracket of EUR 50 million of taxable revenues is already taxed or whether just the part of turnover above EUR 50 million is taxed (i.e. if the taxable person has a turnover of EUR 80 million, only EUR 30 million would constitute the tax base). From the wording of the proposal, it seems more likely that the first bracket of EUR 50 million is already taxed.

[145] The number of taxpayers of DST ranges from 120 to 150 companies, half of which American, a third European and the rest Asian (Johnston, 2018).

To avoid potential double taxation caused by corporate tax and DST, the 2018 Directive Proposal expects Member States to allow "businesses to deduct the DST paid as a cost from the corporate income tax base in their territory, irrespective of whether both taxes are paid in the same Member State or different ones"[146].

As the EU Commission, obviously, did not intend to mandate specific corporate tax rules, this expressed 'expectation' of a cost deduction is merely mentioned in the preamble, and is not prescribed in the substantive body of the proposed directive.

DST Directive Proposal aims at:

- protecting the integrity of the single market;
- avoiding erosion of national tax bases, safeguarding social justice and equality between all societies operating in the EU;
- fight aggressive tax planning and close the international regulatory loopholes that allow some digital organisations to evade tax in countries where they operate and create value.

The proposal incorporates the principles of good tax governance in the EU to combat tax base erosion and profit transfer by digital multinationals.

The DST is a first attempt of an automation tax within the digital single market that identifies the central role of the user in the digital value creation. It is a tax that has a targeted scope that is levied on revenues generated by the provision of certain digital services characterised by value creation by users. The business models covered by the Directive are those which could not exist in their present form without the participation of users.

However, the taxable item is the revenue from the monetisation of the user contribution and not the user's own participation. The central point of the tax is therefore the income derived from the monetarization of the user's contribution: the value obtained by the traffic managers of the users' personal data[147].

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[146] The wording "*it is expected that Member States will allow business to deduct the DST*" indicates that this cost deductibility is a strongly recommended option.

[147] Rosembuj T. (2018). *Inteligencia artificial e impuesto*. Barcelona, p.77.

The DST aims to tax, in the country in which they are produced, the revenues generated by a series of digital services that are characterized by the decisive role played by users.

In particular, the income from the provision of the services indicated in Article 3 of the proposed Directive, which are:

- services consisting of placing on a digital interface targeted advertising to users of that interface. Taxation applies regardless of whether the digital interface is owned by the person responsible for the placement of the advertisement;
- brokering services, consisting in making a multisided digital platform available to users to connect and to interact with other users, potentially facilitating the direct exchange of goods and services. However, it excludes platforms that allow user interaction, but through communication services or payment services, and crowdfunding services are also excluded[148];
- the transmission of data collected by users and generated by their activities on digital interfaces and information which they have, knowingly or not, provided through the use of digital platforms[149].

The tax has a rate of 3% and is executable by the Member State or Member States in which the users are located. This approach is based on the principle of value creation by the user defining the scope of the DST according to which it is the participation of the user in the digital activities of the company that generates the value for the same enterprise, which does not always involve a payment by the user. Consequently, it is the Member State in which the user is located that with the taxation rights for DST, regardless of whether the user has contributed financially to the generation of revenue for the enterprise.

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[148] The European legislator excludes from the scope of the measure, the distribution of video, audio or text content by means of a digital interface by companies, although it is doubtful whether these services are free of charge. The legislator argues that DST is not a tax on the collection of data, on the use of data by companies for internal purposes, or on the sharing of data between companies free of charge. The tax shall apply in the case of transmission of data derived from user activities on digital interfaces for consideration.

[149] Di Tanno T., *La Web tax europea: una misura innovativa ed emergenziale,* in *Corriere Tributario*, 20/2018, p. 1533-1534.

However, the chargeability of the tax payment by several Member States following the principle of creating the value of users residing in their territory, cannot disregard the implementation of a formula for the fair distribution of tax revenue among the countries involved.

The proposal provides that the taxable revenue earned by the company through the contribution of users in different Member States or third countries is allocated proportionally and according to the type of taxable service[150].

When it is a service consisting of placing advertising on a digital interface, the number of times an advertisement appears on the devices of users in a Member State is taken into account. However, as regards the provision of multilateral digital interfaces, a distinction is made between interfaces that act as intermediaries in transactions between users and those that do not. In the first case, the allocation of taxable revenue to a Member State shall be made based on the number of users entering into a sale and purchase transaction using a device in that Member State. In the second case, account shall be taken of the number of users who hold an account that has been opened using a device in the Member State.

Finally, where there is a transmission of the collected data, taxable revenue is allocated according to the number of users who generated the data using a device in a Member State. The allocation to the States of taxable profits obtained by the taxable person is therefore based on an apportionment formula adapted to the criteria for locating the user in relation to taxable services.

The taxable person shall be solely responsible for discharging the tax obligation and the formal identification and declaration charges. In this regard, the proposal provides for the establishment of a "One-Stop-Shop" to enable the taxpayer to meet his obligations from a single location (the Member State of identification), and the possibility, for consolidated groups, to designate a group entity to pay the tax.

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[150] https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_common_system_digital_services_tax_21032018_en.pdf, Article 5.

If the DST is enforceable by several Member States, the State in which the taxpayer accesses the “One-Stop-Shop” system will, in turn, have to inform and transfer to the other Member States their share of the DST.

Besides, the proposal for a directive requires each Member State to take measures to prevent the evasion and abuse of the DST. Fiscal and verification inspections should, therefore, be governed by the law of each State[151].

4. Common Corporate Tax Base and Common Consolidated Corporate Tax Base (CCTB/CCCTB)

One of the possible solutions on which the European Union relies, in the search for alternatives to overcome the challenges posed by the taxation of the digital economy, is the proposal for a common tax base for corporation tax.

It was developed for the first time in 2011: provision was made for an optional system of common rules for calculating the tax base of companies tax-resident in the European Union and branches of companies from third countries. The aim of the proposal was not to create anti-circumvention legislation but rather to develop an instrument to support and promote the single market.

The European Commission announced in 2015 its intention to develop a new model, characterised by mandatory implementation and a phased approach. In 2016, therefore, two proposals for directives are presented, each representing a single stage of a reform, which is, however, unique and aimed at achieving a system of company taxation at the Community level.

The first step is the proposal in COM (2016) 685, known as the CCTB Proposal (Common Corporate Tax Base), which introduces the rules for calculating a common corporate tax base. Undertakings which have to comply with the requirements of the Directive should be subject to the laws of a Member State and should form part of a consolidated tax with a turnover of more than EUR 750 million in the tax year preceding

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[151] Rosembuj, T. (2018). *Inteligencia artificial e impuesto*. Barcelona, p. 80-82.

the relevant tax year; the forecasts may also apply to a non-Community State with a permanent establishment in one or more Member States.

The second stage, COM (2016) 683, known as the CCCTB Proposal (Common Consolidated Corporate Tax Base), defines the rules for assigning a percentage of taxable profits to a consolidated company considering the single tax base. According to the proposal, the tax bases of all group members are added together in a consolidated tax base, which is calculated by ignoring profits and losses from intra-group transactions.

The implementation of such a regime would facilitate tax harmonisation in the EU and would also serve to eliminate transfer prices because by consolidating the single market tax base, losses in one Member State would be offset against profits in another[152]. The establishment of the CCCTB could lead to the revision of the rules on the permanent establishment and their approximation to the concept of economic presence, based on digital transactions, the number of users of platforms and the volume of personal data stored.

The tax payable by each consolidated, taken individually, will be calculated by applying the national tax rate, which is not unified as is the case for the tax base, to the percentage allocated.

The European Commission Communication, COM (2017) 547 Final, entitled "*A fair and effective tax system in the European Union for the digital single market*", highlights the strong need to establish a modern tax framework at EU level to exploit the opportunities offered by digital technology and ensure fair taxation. For all companies to be able to innovate, develop and grow, there must be a level playing field to avoid tax arbitrage.

According to the Commission's estimates, on average, national digital business models are subject to an effective tax rate of 8.5%, twice that of traditional businesses. This difference would appear to be caused by the characteristics of digital enterprises and the high tax relief granted in relation to intangible assets, which constitute the largest part

[152] Rosembuj, T. (2018). *Inteligencia artificial e impuesto*. Barcelona, p. 104-107.

of the assets of this type of enterprise. In addition to this, the lower tax burden borne by cross-border companies can also be offset by aggressive tax planning.

One of the main challenges facing the European Union is to reform the international fiscal framework, conceived at the beginning of the twentieth century and no longer in line with current reality, highly globalised and with digitised enterprises. This means that the principle that profits should be taxed where value is created is not very effective, because often in a digitised world, it is not easy to determine. The key issues are where to tax and how to tax; in order to solve them, it is necessary to find a reasonable solution that will allow us to establish, for tax purposes, where economic activities are carried out and where value is created.

In the Commission Communication, the objectives set for achieving a global and modern taxation of the digital economy are equity, competitiveness, single market integrity and sustainability. Steps must be taken to ensure that companies' profits are taxed at the place where the value is actually created while maintaining a level playing field so that all businesses pay the right share of taxes. There is also a need to increase the competitiveness of the Union by removing tax barriers to allow businesses to expand within the single market.

The optimal solution takes a long time to be taken, due to the continuous evolution of the digital economy and the diversity of ecosystems in which digital businesses create value. However, as time goes on, tax losses also increase. For this reason, together with the search for a complete solution in the long term, there are also immediate, complementary and short-term measures that should be considered to protect the direct and indirect taxation bases of the Member States. Various ideas have been circulated in the Union and internationally to take account of digital activities in a differently from the international tax framework for traditional businesses: for example, among short-term options, there is a countervailing charge on the turnover of digital companies, that is on all non-taxed or only partially taxed revenues generated by all Internet-based business; or a withholding tax on digital transactions, discharging, on a gross basis, certain payments to non-resident suppliers of goods and services ordered online. Finally, there is the

possibility of making a levy on revenue generated by the provision of digital services or advertising activities.

5. Some consideration about the DST

The DST is explicitly characterized in the proposed Directive as an 'indirect tax', as its legal basis was justified on Article 113 of the TFEU, providing for the Council, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, to adopt provisions for the harmonization of Member States' rules in the area of indirect taxation. This type of harmonization is justified because indirect taxes can create an immediate obstacle to the free movement of goods and the free supply of services within an internal market, while they can also create distortions in competition. Moreover, the incentive of the proposed DST was to harmonize within the EU the already applicable unilateral measures adopted by several Member States, classified as 'equalization taxes' and falling principally on the revenues generated from the provision of certain digital activities.

Should the DST be treated as an indirect tax or even a direct tax[153], it must in any case be compatible with the principle of "national treatment"[154] reflected in the prohibition of discriminatory internal taxation reserved to imported products as opposed to similar domestic products. The compatibility assessment of the DST with EU primary law will follow an analysis based on the potential discriminatory nature of the DST with regard to an indirect effect that it could have on products transferred to a – market – Member State from another Member State due to the imposition of the tax on the digital intermediary via which the transfer of the product is facilitated[155]. This assessment concerns the case of digital intermediation services subject to the tax and not the rest of taxable services, as they do not seem to have an immediate effect on the underlying sale

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[153] F. van Horzen & A. van Esdonk, Proposed 3% Digital Service Tax, 25(4) Transfer Pricing J. 267–272 (2018) (arguing in favour of treating DST as a direct tax).

[154] It refers to a system of destination-based taxation where the country of final sale (destination) is to enforce the regulatory taxation at issue.

[155] According to Art. 110 of the TFEU.

of goods.

The discussion here deals with the concept of ‘products’, as laid down in Article 110 of the TFEU (section 4.1.1.) as well as with the meaning of the term ‘internal taxation’, (section 4.1.2.) based on the criteria set by ECJ case law[156].

These provisions aim at ensuring the free movement of goods between the Member States in normal conditions of competition by eliminating all forms of protection which could result from the application of internal taxation that discriminates against products from the other Member States[157]. In other words, Article 110 of the TFEU guarantees the complete ‘neutrality’ of internal taxation regarding competition between domestic and imported products, and in that sense the said prohibition applies whenever a fiscal charge is liable to discourage imports of goods originating in other Member States in favour of domestic goods. The scope of Article 110 of the TFEU seems to be limited to prohibition of discrimination against ‘products’ and does not explicitly cover the case of services. Therefore, for Article 110 of the TFEU to apply, the question is whether internal taxation ‘indirectly imposed on products’ is to be read to include also internal taxation imposed – in principle – on services which, however, facilitate the supply of products in a way that the tax effectively affects the underlying importation of certain products. In this respect, the indirectly discriminatory result of the tax is based on its effects. This broad interpretation of Article 110 of the TFEU is based on both its wording and its object and purpose of ensuring equal treatment of foreign and domestic goods.

As stated in ECJ case law[158], it is irrelevant whether a tax is imposed on products as such or on the activities connected with the provision of products, as the very rationale of Article 110 of the TFEU – aimed at removing any disguised restrictions on the free movement of goods – requires that it be applied to a tax liable to have an immediate effect

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[156] DK: ECJ, 27 Feb. 1980, Case C-171/78, *Commission v. Denmark*, ECLI:EU:C:1980:54, para. 4.

[157] Article 110(1) and (2) of the TFEU provides that “*no Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products. Furthermore, no Member State shall impose on the products of other Member States any internal taxation of such a nature as to afford indirect protection to other products”*.

[158] DK: ECJ, 27 Feb. 1980, Case C-171/78, *Commission v. Denmark*, ECLI:EU:C:1980:54, para. 4.

on the cost of the national and imported product[159].

This is because irrespective of the fact that such tax appears to fall on the provision of the intermediation service and thus, directly affects the service of ‘digitally facilitated trade’ operated through a digital platform.

It is also possible that, as the objective of digitally facilitated trade is the underlying sale of goods to consumers, the DST might plausibly at the same time indirectly affect the supply of products offered for sale[160]. The indirect effect in this case should be reflected in the cost of the products offered to customers via the digital interface. The cost of the product offered to final customers under the cover of the interposition of a digital interface between the trader and customers and facilitating the conclusion of the transaction of the sale, is likely to be higher if it were to incorporate the cost of the intermediation service which bears the DST.

Although a tax appears to be formally levied on the overall turnover of the companies and undertakings required to pay the tax, it has the effect – through the economic mechanism of costs being passed on – of increasing the cost price of goods sold within national territory and goods transferred to other Member States. Based on this, the DST could be considered as having an immediate effect on the cost of the products the sale of which is facilitated through the digital interface. Therefore, it is reasonable to assume that the amount payable by the companies and undertakings subject to the DST could be passed on in the cost price of the goods in each transfer (possibly through an increase in the charge for the making available of the digital interface to both traders and users, or only to traders who then in turn could increase the sale price of the product they offer, in which case the final burden will be borne by the consumer). Consequently, the

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[159] Schöttle & Söhne (C-20/76), paragraphs 13- 16.

[160] Case C-418/02, Praktiker Bauund Heimwermärkte AG, ECLI:EU:C:2005:425, para. 34.

In this case having regard to services provided in connection with retail trade and the right to trade marks, the ECJ classified the activity connected with retail trade, namely the sale of goods, as a ‘service’, for the purposes of falling under the trade marks regulation. However, the service at issue consisting in, inter alia, selecting an assortment of goods offered for sale and in offering a variety of services aimed at inducing the consumer to conclude a transaction with the trader rather than with a competitor. The activities of a trader thereof consist in making distribution of goods possible without being confined to carrying out such distribution.

DST could be seen as a tax having an effect of increasing the market price of categories of goods supplied via the digital platform offered by a person subject to the DST in proportion to the tax element included therein and, as a result, it would risk being classified as a charge indirectly levied on goods. On the assumption that – based on established ECJ case law – the DST could be regarded as a tax indirectly imposed on products the sale of which is facilitated via the digital interface, the provider of which bears the tax burden, the question that remains is whether such tax would actually constitute 'internal taxation' for the purposes of Article 110 of the TFEU.

It is beyond doubt that the proposal by the EU Commission for a DST has been the subject of extraordinary controversy due to the nature of the tax, its implications for the existing tax treaty network, its design, its temporary status and the purpose it aims to achieve. It is also doubtful whether an international consensus will be reached in the foreseeable future on the taxation of digital companies and their activities. However, the EU is rushing to regulate the currently blurred landscape because of the proliferation of unilateral DST measures on behalf of many Member States to avoid the further fragmentation of the internal market. Nevertheless, the DST proposal might be problematic as regards the inclusion of 'intermediation services' in taxable services, from the perspective of Article 110 of the TFEU. This is because the taxation of digital services facilitating the underlying sale of foreign products as opposed to domestic products might risk being classified as discriminatory internal taxation imposed indirectly on foreign products sold under a digital intermediation platform, as opposed to similar products sold domestically in traditional stores. This classification would imply a protectionist tax policy imposed on behalf of the EU which is unconditionally prohibited under Article 110 of the TFEU. However, any appraisal of the DST from an anti-protectionist perspective, would rely on the market effects that this tax would have – which, however, cannot be accurately measured and depends on multiple factors. In this regard, the product and taxation similarity tests applied for purposes of Article 110 of the TFEU are not based on statistical market-based evidence, but on the criteria that the ECJ applied in its case law and on the assumption that presumably, online platforms facilitate more those

transactions in foreign products than transactions in domestic products[161].

The conclusion based on the above mentioned evaluation is that the DST bears the risk of being regarded as discriminatory internal taxation indirectly imposed by one Member State on products coming from another Member State, based on which imported products are more onerously taxed, and provided that such tax only partly compensates for the tax borne by similar domestic products. On the other hand, if market evidence proves that the no discrimination de facto occurs between foreign and domestic products sold via a platform, the DST would escape classification as discriminatory internal taxation under Article 110 of the TFEU.

6. Critical Features of the DST

Based on the key features discussed above, let us now examine the challenges that DSTs are facing.

First, because DST only applies to the specific digital business models, it has been censured as ring-fencing[162], or segregating, the identified digital business models where tax challenges are primarily manifest with mobile IP and significant user participation. The proponents of the Marketing Intangibles and Significant Digital Presence proposals argue that DST is against the idea of a level playing field by penalizing the big or initial players in the market.

Second, DST has been scrutinized as a disguised direct tax, or corporate income tax, which may result in double taxation in income tax treaties[163].

Most countries have an income tax system and conclude tax treaties with their main trading partners to eliminate double taxation on certain income when two or more countries contribute to such income at the same time. One country may contribute to the

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[161] G. C. Hufbauer & Z. Lu, The European Union's Proposed Digital Services Tax: A De Facto Tariff, Peterson Institute for International Economics 18–15 (June 2018), at 1–11, https://piie.com/system/files/documents/pb18-15.pdf (accessed 26 March 2020).

[162] Haslehner, W., Kofler, G., Pantazatou, K. and Rust, A., 2019. *Tax And The Digital Economy*, The Netherlands, p.101 ss.

[163] Y. R. Kim, Digital Services Tax: A Cross-Border Variation of the Consumption Tax Debate, November 2019.

income as a residence country of a taxpayer, and another country might contribute to the same income as a source country where the taxpayer deploys investment. However, if both countries claim to levy tax on the same income, double taxation occurs. Therefore, when a State exercises primary tax jurisdiction on certain income based on the rule established by an income tax treaty, the other contracting State should grant to the first State tax jurisdiction and exercise residual tax jurisdiction or offer measures to eliminate double taxation on the same income, such as a foreign tax credit or an exemption from tax.

In theory, the double taxation problem does not occur if two taxes are imposed on different tax bases. For example, many countries impose VAT on a business's consumption, or gross margin, and at the same time they impose corporate income tax on the business's net income[164].

Although the tax base of VAT and that of corporate income tax are not exactly the same, they may significantly coincide. However, this is not double taxation, because VAT is imposed on taxpayer's consumption whereas corporate income tax is imposed on the taxpayer's net income. The same explanation upholds for DST.
The tax base of DST is gross income of some digital firms and that of income tax is net profit, or net income after deducting expenses from gross revenue, of the digital firms, and thus accusing the DST of creating a double taxation problem is not likely a legitimate concern.

However, the opponents of DST argue that DST should be considered as a disguised corporate income tax. If the object of the DST is to tax profits where value is created, then the object itself admits that it relates to "profits," which is the tax base of

[164] For example, a toy manufacturer located in a country having a 10% VAT and 20% corporate income tax. The toy manufacturer buys the raw materials for $4.00, plus a VAT of $0.40—payable to the government—for a total price of $4.40. The manufacturer then sells the toy to a retailer for $10.00 plus a VAT of $1.00 for a total of $11.00. However, the manufacturer renders only 60 cents to the government, which is the total VAT at this point, minus the prior VAT charged by the raw material supplier. Note that the 60 cents also equal 10% of the manufacturer's gross margin of $6.00. In addition, the toy manufacturer should pay corporate income tax on its net income of $6.00, which is the gross revenue of $10.00 minus deductible expenses for the raw materials of $4.00, at 20% corporate income tax rate, which is a total of $12.00 corporate income tax. This example shows that tax base of VAT and corporate income tax may significantly overlap, but it is still not considered as double taxation.

direct tax, or corporate income tax. The circumstance that the tax base is gross revenues does not necessarily negate the suspicion of direct taxation because other direct taxes, such as withholding tax as a collection mechanism of income tax, are also levied on gross profits.

The DST seems to qualify as a turnover tax due to its levy on the annual revenues (gross revenues net of VAT and other similar taxes) of digital companies earned from the taxable activities and therefore, it is supposed to escape falling within the scope income tax treaties[165]. However, it is also arguable that such tax, in reality, is levied on the 'income' derived from the taxable digital activities.

The taxable period of DST is also a yearly basis, rather than per transaction basis, which is more similar to direct taxation than indirect taxation. If the DST is a direct tax, then there is a risk that a DST is within the scope of "Taxes Covered" in Article 2 of the OECD Model Tax Convention on Income and on Capital. Such risk leads to the treaty-level concern of double taxation.

"Interim measures" for the taxation of the digitalized economy, such as the DST, also have a tax treaty dimension. They raise, inter alia, the question whether they have to be viewed as taxes on 'income' or 'elements of income', which are core notions for the delimitation of the substantive scope of tax treaties[166]. Relating to possible interim measures to address the tax challenges arising from digitalization, already the OECD in its 2018 Interim Report has accentuated the need for compliance of such measures with international law. Any new tax that a country introduces must be in compliance with its existing international obligations, including tax treaties, and this compliance with tax treaties is also an essential aim of the DST proposal[167].

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[165] For criticism on the nature of the DST resulting in circumvention of tax treaty rules, see R. Finley, EU Digital Services Tax Attempts to Bypass Treaty Rules, Tax Notes Int'l 92 (29 Oct. 2018), p. 534–535. But see S. Wagh, The Taxation of Digital Transactions in India: The New Equalization Levy, 70(9) Bull. Int'l Tax'n 538 & 550 (2016) (examining the nature of the Indian equalization levy and notes that although such equalization tax is levied on the gross revenues, it is in nature a tax on the income (income as a term has the widest Connotations) paid to a non-resident service provider derived from the provision of services to an Indian resident or a PE in India. In fact, the equalization levy is clearly similar to a withholding tax imposed on royalties or fees for technical services).

[166] 2018 OECD BEPS Interim Report, paragraph 413 – 431.

[167] Indeed, the DST proposal is the Commission's reaction to the invitation to adopt proposals responding

If, conversely, the DST would have to be viewed as a tax on 'income' or 'elements of income' within the meaning of Article 2 OECD Model and hence generally fall within the scope of tax treaties, a possible conflict between the levy of DST and the existing rules of tax treaties, especially with regard to provisions along the lines of Articles 5, 7 and 23 OECD Model, would arise. However, based on the criteria set out by the OECD, a balancing of the various factors leads to the conclusion that the DST is not a tax covered by tax treaties[168], a position – explicitly or implicitly – shared by nearly all commentators[169].

If it were eventually to be determined that the DST is covered by tax treaties, EU law would generally override tax treaties, but difficult questions might arise under Article 351 TFEU[170].

Concluding that the DST would not fall under Article 2 OECD MC also means

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to the challenges of taxing profits in the digital economy by the ECOFIN conclusions of 5 Dec. 2017. At this time, many Member States had expressed an interest in devising temporary measures aimed at collecting more revenues resulting from digital activities in the Union, while ensuring these measures would remain outside the scope of tax treaties. See Council of the European Union, Responding to the Challenges of Taxation of Profits of the Digital Economy – Council Conclusions, 15445/17, FISC 346 ECOFIN 1092 (5 Dec. 2017), para. 24.

[168] See for the main arguments and further references D. Hohenwarter, G. Kofler, G. Mayr & J. Sinnig, Qualification of the Digital Services Tax Under Tax Treaties, 47 Intertax 2 (2019).

[169] O'Shea, Comments on the EU's Proposed Indirect Digital Service Tax, 90 Tax Notes Int'l 1373, 1377 (2018); Opinion of the European Economic and Social Committee of 12 July 2018 on 'Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence', and 'Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services' OJ C 367/73 (10 Oct. 2018); Shaheen, Income Tax Treaty Aspects of Non income Taxes: The Importance of Residence, 71 Tax Law Rev. 583, 620 et seq. (2018)

[170] More generally, regulating the treatment of non-EU nationals in internal legislation may create conflicts with existing bilateral tax treaties and call for an examination of the scope of Art. 351 TFEU. A potential 'treaty override' can, e.g. already be found in ATAD, Art. 7, which requires the inclusion of foreign, tax-treaty exempt permanent establishments in the scope of CFC rules, thereby arguably forcing Member States to override the exemption method in their tax treaties with third countries. On the other hand, the Union is usually careful not to upset the existing tax treaty network between Member States and third countries. This is clearly visible, e.g. with regard to the 2018 SDP Directive Proposal, supra n. 64, where Art. 2 specifies that the Directive would, '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', only apply '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'. Complementing this delimitation of the Directive's scope, the Commission has simultaneously issued a recommendation to Member States to (bilaterally) amend their tax treaties with third countries and to include provisions on significant digital presences (see EU Commission Recommendation of 21 Mar. 2018 relating to the corporate taxation of a significant digital presence, C (2018)1650 (21 Mar. 2018)).

that unrelieved double burdens occur where revenues are taxed under DST and profits under a – domestic or foreign – corporate income tax. A cross-border taxable person could be subject to double (and, hence, over-) taxation for which no relief is contemplated by Article 23 OECD Model.

Further, neither the DTC's mutual agreement procedure under Article 25 OECD Model nor the EU dispute-resolution directive's dispute resolution mechanisms would apply. Creating a new tax that falls outside the scope of existing DTCs modelled on the OECD Model seems to be backwards rather than forwards toward avoiding double taxation.

Thirdly, various unilateral DSTs potentially discriminate businesses based on nationality. Although it is eventually an empirical question that requires evidence on whether the majority of the companies subject to DST are foreign multinationals from market jurisdictions, it has been deeply suspected that the revenue threshold would only be satisfied by American tech giants[171].

On this latter point of the challenges faced by the DST, the United States has been a major opponent to the DST general concept. In the letter of January 29, 2019, by Senators Grassley and Wyden to US Treasury Secretary Mnuchin, they expressed concern about unilateral DSTs, because they are "designed to discriminate against US-based multinational companies". On March 12, 2019, Treasury Department Assistant Secretary for International Tax Affairs, Chip Harter, expressed concern that under the WTO, trade agreements, and treaties the French DST proposal could be challenged as discriminatory vis-à-vis US companies, and the US is opposed to any digital services tax proposals.

7. DST and VAT

First, it should be recalled that VAT is a broad-based tax on final consumption that is meant to be neutral on businesses through the mechanism of credits and refunds. Consumption is a tax base that has the advantage of being relatively stable and predictable

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[171] R. Y. Kim, *Digital Services Tax: a cross border variation of consumption tax debate*, November 2019.

and that does not have negative effects on production, job creation and investment. This is one of the reasons why the OECD, the International Monetary Fund (IMF) and the World Bank routinely recommend the adoption of VAT systems, rather than other direct taxes, such as taxes on labour and corporate income. By contrast, DST is a narrow-based tax meant to directly affect businesses – large digital businesses in particular – without any intention (prima facie) to affect consumers.

It must also be remembered that, according to the explanatory memorandum of the DST Proposal[172], the general objective of the proposed tax is:

- to protect the integrity of the Single Market and to ensure its proper functioning;
- to make sure that public finances within the Union are sustainable and that the national tax bases are not eroded;
- to ensure that social fairness is preserved and that there is a level playing field for all businesses operating in the Union; and
- to fight against aggressive tax planning and to close the gaps that currently exist in the international rules, which make it possible for some digital companies to escape taxation in countries where they operate and create value.

The first objective (protection of the single market) refers to the risk of fragmentation that would occur in the case of the adoption of non-harmonized DSTs by several EU Member States. The second and fourth objectives (sustainable revenue for the Member State and fighting against aggressive tax planning and the erosion of Member States' tax bases) should probably be nuanced in view of the fact that, according to the European Commission itself, the DST "would raise additional revenues for national budgets, although the expected additional revenue from the tax would be rather moderate taking into account the narrow scope and application of thresholds"[173].

The main benefit of the proposed tax would be the third objective listed above, *i.e.* to "improve the perception of fairness for citizens by ensuring a minimum level of taxation in the EU for companies that rely the most on user contributions and data". In

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[172] Explanatory memorandum, p. 3 DST proposal.

[173] Impact assessment, pp. 98 - 99 DST proposal.

fact, the DST is not primarily intended to generate revenue for Member States (the expected revenue would be around EUR 5 billion per year), but rather to attempt to increase the level of satisfaction and perception of fairness by EU citizens (as theorized under the "ability to pay principle" and "vertical equity concept", supporting the idea that everyone should pay their "fair share of tax") by means of an increased taxation of some (well-known) large businesses (even if, as noted above, the expected revenue would actually be quite low). In contrast, VAT is a key component of Member States' revenue (accounting for around 30% of their overall tax revenue). VAT has a broad scope of application and a flat rate, which does not allow for the personal situation of the taxpayer to be taken into account. For that reason, many scholars and commentators criticize VAT, calling it a "regressive tax system"[174].

Regarding the tax base of the DST, the scope of application *ratione materiae* of DST is therefore very limited and focuses on instances where the contribution of users to the creation of "value" for a company is more significant, albeit not resulting in "appropriate levels" of taxation in the market jurisdiction when the current corporate tax rules of the Member States are applied. DST would thus act as a sort of "equalization tax", not in the traditional sense of raising the price of an imported good or service to match the domestic offer, but in the (new) sense of raising the level of taxation of some non-resident businesses to match the level of corporate taxation supported by resident businesses. By contrast, the tax base under VAT includes, in principle, all supplies of goods and services made by a taxable person acting as such, irrespective of the nature of the goods delivered or the services performed[175] .

This broad scope of application is meant to maximize the revenue and to ensure the neutrality of the tax in the sense of not discriminating between the different economic sectors.

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[174] *See*, for example, L. Ebrill et al., *The Modern VAT* p. 106 (IMF 2001); I. Crawford, M. Keen & S. Smith, *Value Added Tax and Excises: Commentary*, Prepared for the Report of a Commission on Reforming the Tax System for the 21st Century, available at https://www.ifs.org.uk/uploads/mirrleesreview/dimensions/ch4.pdf.

[175] *See* arts. 1, 2 and 9 Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

As far as the scope of application is concerned, DST could therefore be compared to excise taxes[176], which also have a narrow scope of application. However, excise taxes have (or at least are meant to have) a deterrent effect or compensate for the negative externalities of the products subject to excise (tobacco, alcohol and energy products), which is probably not the case with DST (except considering that the negative externality that is being compensated is the lack of corporate taxation of the providers of the targeted services).

Moreover, DST should be calculated on the total gross taxable revenue (meaning the revenue subject to DST) of the supplier, net of VAT and other taxes. The revenue taxed would mostly arise from B2B transactions, but could also arise from B2C transactions (for example, if a sharing economy platform asks for remuneration from both parties). In any event, the "users" that create the value include both businesses and consumers.

By contrast, under the VAT system, the taxable amount includes everything that constitutes consideration obtained or to be obtained by the supplier as a counterparty to a supply of a good or service, including taxes (excluding the VAT itself). It would not include DST, because the latter is not being paid by the customer. Both B2B and B2C supplies are subject to VAT (multi-stage tax); however, input VAT paid by businesses may, in principle, be deducted or refunded so that VAT, in principle, only affects consumers. On the other hand, as already highlighted, DST is intended to affect (certain) businesses. That being said, it is noteworthy that recital 27 of the Preamble of the DST proposal provides that EU taxable persons may be allowed to deduct DST from their domestic corporate income tax (CIT). This may seem surprising, but makes sense to a certain extent because not providing relief for EU businesses would prevent the equalization feature of the tax from being achieved (since it may be assumed that EU digital businesses are already paying a fair or higher share of CIT compared to non-EU

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[176] An excise tax is a legislated tax on specific goods or services at purchase such as fuel, tobacco, and alcohol. Excise taxes are intranational taxes imposed within a government infrastructure rather than international taxes imposed across country borders. Excise taxes are primarily a business tax, separate from other taxes a business must pay, like income taxes.

digital businesses).

In addition, for VAT purposes, head office or branch (same legal entity) supplies are considered to be outside the scope, but intra-group supplies (including different legal entities) are within the scope, except when occurring within a VAT group (there are no cross-border VAT groups under the current state of the VAT Directive). By contrast, for DST purposes, intra-group supplies (entities that are fully included in consolidated financial statements, including different legal entities) would always be outside the scope.

Even regarding to the tax rate there are differences between DST and VAT. In fact, the DST tax rate is set in Article 8 of the Directive proposal at 3%; while the VAT rates in the European Union are much higher by comparison: between 17% and 27%[177].

The VAT system is designed to remain permanently. As mentioned, it represents an important share of Member States' revenue.

The DST, however, is meant to be an interim measure to address, in the short term, the issue of the insufficient level of corporate taxation of digital giants under the current tax treaties signed by Member States. Logically, it should therefore be rescinded if and when the issue is properly addressed through the adoption of an amended definition of the PE concept that would take into consideration the virtual presence of these businesses. This was confirmed by the Member States during the 6 November 2018 ECOFIN Council meeting: "all member states agreed that the directive should expire once there is a comprehensive solution to taxing the digital economy at OECD level"[178].

From this overview we can conclude that VAT is a broad tax on consumption that, in principle, remains fully neutral for businesses, while DST is a narrow tax on certain revenue of businesses in the digital sector and is therefore meant to affect them directly while being neutral on consumers. VAT must be collected by taxable persons defined in a broad way, while DST must only be collected by large companies with significant worldwide turnover and significant revenue subject to DST. When considering the principle of neutrality, while the broad-based VAT aims at being neutral and equitable

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[177] Article 98 of the VAT Directive 2006/112/EC.

[178] Council Meeting conclusions, 6 November 2018 ECOFIN.

between sectors and between forms of business activities, the narrow-based DST specifically seeks to target one sector and one form of business, which cannot be blamed for producing negative externalities (in contrast with sectors in which excise taxes apply). Accordingly, the idea of neutrality is completely undermined. More precisely, DST introduces double ring-fencing: it targets a small number of digital giants and further targets a few specific activities of these businesses.

While VAT is calculated on a transaction basis, using the counterparty paid by the customer to the supplier as the "taxable amount", the taxable amount for DST needs to be defined by apportioning the total revenue of a contract to the Member States in which "users" are located; the "users" in this case not being parties to the transaction itself but being identified as having created "value" for the supplier and allowing it to sell its services at a high price. This also means that the place of supply and related allocation of taxing rights rules are totally different than those that apply in the area of VAT, even though the rules for locating the users have similar traits.

In conclusion, it should be noted that on the basis of the above comparison between the DST and the VAT system (which shows clear differences between the two taxes), the adoption of individual legislation establishing the DST would not constitute an infringement of Article 410 of the VAT Directive (2006/112) in which Member States committed themselves to refrain from adopting new turnover taxes similar to the harmonised VAT system.

The issue of the compatibility of indirect taxes with Article 401 of the VAT Directive, in accordance with the case law of the Court of Justice of the European Union, will be analysed in the next chapter.

8. Conclusive remarks of the DST

It can therefore be said that the (proposal for) Digital Services Tax Directive is, in short, going to be, irrespective of its actual implementation, an archetype of taxation of digital services which, may well become a useful instrument for interpreting domestic choices in the European Union, as well as a benchmark for comparing the compatibility of national positions with the Euro-unitary framework.

The focus of the (proposed) Directive is to identify the tax basis which is identified in a specific category of digital services: those in which there is an active contribution of the user, which participates in the formation of value. Despite the diversity of the services produced and the peculiarity of the different platforms, in all these cases the tax base is constituted and determined by what in the text of the directive is defined as the "*Monetisation of user input*" that is the creation of value that comes directly from a proactive role of the user of the service. It is precisely the dynamism of the latter (and not its mere passivity) that helps to create the value of the platform, so its appeal, for example, for advertisers[179] and consequently also the legitimation, in a logic of international tax law, of the country of residence of the consumer, to the exercise of tax power. It is true that despite the clearly revolutionary system of the Digital Services Tax, the latter does not wish to depart from the classical foundations of international tax law, particularly the link between the tax assumption and the territory of the country which intends to subject it to a tax.

This assumption consists, in the Digital Services Tax, in the provision of a digital service to the value of which the consumer of the service has contributed, which in turn is located in the territory of the country claiming the application of the tax. In using the Commission's own words, it made the objective of the directive clear: "*What DTS targets*

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[179] For example, within social networks, there are differences between platforms such as Facebook and Google+. The second of the two despite being promoted and supported by the largest multinational in the sector, closed for months because unable to generate value. This is not so much because of the technical poverty of the computer solution (really avant-garde) or the cost of the service (which is free) but because, simply, it is not populated by users, which discourages participation (in a kind of vicious circle) and therefore advertising (no company has an interest in promoting its image in digital places that no one frequents).

is the transmission for consideration of data obtained from a very specific activity (user's activity on digital interfaces)".

This is therefore a more selective objective than the first proposals for a levy on digital services, taking into account the fact that only activities in which the consumer has a significant role can be intercepted by this form of levy. On the other hand, both the traditional models of online e-commerce (*Ebay* , and perhaps even *Amazon*, although in this context the profiling of the user by the multinational and the advanced management of the Feedback in the dynamics of the prices may give rise some reserve), and the services in which the final consumer remains merely passive (or where de facto profiling ends in a mere optimization of service delivery (here the reference could be to the models such as *Premium Youtube* managed by Alphabet, and *Spotify*) remain virtually excluded.

Despite the filter of qualitative nature, the European Commission has considered appropriate to apply the tax (with a rate of 3% traceable to the gross proceeds of the activity altogether understood) to the net of the eventual tax on the value added however exact (Art. 3, paragraph 2 of the proposal for a directive) to a group of potential taxable persons also identified on the basis of purely quantitative criteria, commensurate with their worldwide turnover and that achieved within the European Union.

Beyond the figures set by the Commission it is useful to underline their identity with those established for the (prospective) application of the CCCTB. In the words of the Commission, the entire Digital Services Tax proposal is in fact a "Second Best" remedy to the failure to implement the CCCTB within the Union due to a lack of consent. As such it is essentially intended to influence the Market makers of certain digital services, leaving aside the smaller operators (the reference made by the Commission in this case is to the "Digital footprint" by potential taxable persons).

The taxonomy of this form of levy, however, remains to be clarified, from a strictly theoretical point of view, as well as the mechanism for allocating its revenue in

light of specific allocation rules which the Commission has been careful to identify, to avoid double taxation throughout the Union or, on the contrary, a real tax jump[180].

From the first point of view, it is difficult to isolate an archetype to which to trace the Digital Services Tax: perhaps, this is not even entirely useful since in the domestic dimension, as we will see, the national legislator has already taken care to extend to the tax in question the VAT rules as regards the powers of control of the Financial Administration and all the formal obligations of the taxable person. It is true that Digital Services Tax almost seems to take the form of an excise duty on digital services, given its concentrated application to certain operators, its indirect nature, the single-stage dimension of its implementation and the determination of the tax base.

There are also doubts about the differentiation profiles with regard to excise duties proper, which operate on different assumptions and respond to different logics than those of Digital Services Tax. In particular, in the case of excise duties, there is a constant reference to the materiality of the good affected by the tax, whether it is a mineral oil or any other good found by that form of taxation. However, it is also true that the progressive emergence of a (purely) digital economy could also lead the tax legislator to adapt forms of levies that are now centuries old to a different way of extracting value. In this case, perhaps, not from the soil or from the processing of certain natural resources, but rather from the extraction of data and subsequent processing using artificial intelligence mechanisms, big data and so on.

Easier, if only from a qualitative point of view, is instead the issue related to territoriality, which carries with it the inevitable profiles regarding the specific compliance of the tax (moreover detailed dealt with by the national legislator).

If the Digital Services Tax has found its justification in the attempt to effectively counteract forms of erosion of the tax base in favour of multinationals not resident in the territory of the European Union (or, more precisely, to realign the power of taxation to the place where the value of services provided through the network is created),it is,

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[180] "*La Tassazione Dell'Economia Digitale Tra sviluppi Recenti e Prospettive Future*", a cura di Alessio Persiani, Università Europea di Roma – Istituto della Enciclopedia Italiana, Roma, November 2018, p. 113 – 115.

however, equally true that once the tax revenue has been redistributed within the Union, the next step imposes its subdivision (an apportionment) between the different States, hopefully because of the presence in the territory of one or the other of those same producers-consumers who contribute to the chain of the value of the service provided.

In this context, the Commission has perhaps adopted the only technically feasible solution. From Brussels in fact came the proposal to consider with suitable element to the localization of the Pro-sumer and consequently important factor in the allocation of the proceeds of tax between states, the IP address (Internet Protocol) of access to the net. This parameter would be understood as an adequate proxy of the actual residence of the individual.

It is known that the geographic reference generated by the IP detection, being not static, can be shielded or even hijacked through the simple use of Software freely accessible on the market or VPN (Virtual Private Network) which do not require extraordinary user preparation[181].

It is reasonable to consider that, despite this vulnerability, the reference to user access and IP still remains an objective parameter, which allows a significant lightening of the burden of the economic operator, as well as the proposal to use the MOSS mechanism to further facilitate compliance.

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[181] "*La Tassazione Dell'Economia Digitale Tra sviluppi Recenti e Prospettive Future*", a cura di Alessio Persiani, Università Europea di Roma – Istituto della Enciclopedia Italiana, Roma, November 2018, p. 116 – 118.

SECTION 3

Since the beginning of the G20/OECD BEPS Project, the future tax regime for the digitalized economy has been under scrutiny – both from a political and from an academic perspective. But neither the Report on Action 1 of the BEPS Action Plan released in 2015[182] nor OECD's follow-up Interim report published in 2018[183] have provided consensus on the way forward.

In January 2019, OECD's Inclusive Framework put together a Policy Note[184] followed by a Consultation Document[185], which are meant to break the impasse at the level of member countries. These publications provide a platform for the ongoing search for consensus-based solutions. On this basis, the Inclusive Framework has recently agreed on a Work Programme to amplify the options until the end of 2020[186].

These official documents start from the assumption that tax measures relating to the digitalized economy may pursue two different goals: the wider aim to reallocate taxing rights between jurisdictions on a global scale on one hand, and the narrow goal of fighting tax avoidance and harmful tax competition on the other hand.

The first goal is addressed by three proposals (Pillar I) and the second one is addressed by the proposal of a "minimum tax regime" (Pillar II) enabling residence countries and source countries alike to levy compensatory taxes if the tax burden on

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[182] *OECD*, Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report: OECD/G20 Base Erosion and Profit Shifting Project, 2015 (Final Report 2015).

[183] *OECD,* Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, 2018 (Interim Report 2018); for an overview see *Ana Paula Dourado*, Digital Taxation Opens the Pandora Box: The OECD Interim Report and the European Commission Proposals, 46 Intertax (2018) p.565 – 572.

[184] *OECD,* Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note, As Approved by the Inclusive Framework on BEPS on 23 January 2019: OECD/G20 Base Erosion and Profit Shifting Project, 2019 (Policy Note 2019).

[185] *OECD,* Public Consultation Document, Addressing the Tax Challenges of the Digitalization of the Economy: OECD/G20 Base Erosion and Profit Shifting Project, published on 13th February 2019 (Consultation Document 2019).

[186] *OECD,* Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy: OCECD/G20 Inclusive Framework on BEPS, published on 31st May 2019 (Work Programme 2019).

corporate profits in those countries which are primarily entitled to tax that profit does not reach an effective tax rate above a certain minimum threshold.

1. First Pillar. New Tax Right and Profit Allocation Rule.

The OECD has put forward three proposals for the allocation of new tax rights, which relate to:

- a "user contribution" approach which tries to align taxation with the existence and activity of "users" of digital services (as opposed to simply consumers) in a jurisdiction[187]; this approach has been championed by the United Kingdom and the European Commission
- a "marketing intangible" approach[188] which allocates (residual) profit to jurisdictions where the taxpayer (a foreign firm) has created a digital or non-digital intangible asset related to its customer base; this approach has been put forward by the United States; it is conceptually not limited to marketing intangibles created in the context of digital business models[189];
- a "significant economic presence" approach which would amend the permanent

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[187] *European Commission,* Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, COM(2018)147 final, 21st March 2018, Explanatory Memorandum, p.7 (Significant digital presence on the basis of "a large user base, user engagement and user's contributions as well as the value created by users for these businesses"; *European Commission,* 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)148 final of 21st March 2018, Explanatory Memorandum, p.7 ("the participation of a user in a digital activity constitutes an essential input for the business carrying out that activity") and Preamble para 1 ("the contribution of end-users to value creation"); *European Commission,* Communication: Time to establish a mod- ern, fair and efficient taxation standard for the digital economy, COM(2018)147 final of 21st March 2018; but see: *European Economic and Social Committee,* Taxation of profits of multinationals in the digital economy, Opinion ECO/459, Adopted on 12th July 2018.

[188] *OECD,* Public Consultation Document, Addressing the Tax Challenges of the Digitalization of the Economy: OECD/G20 Base Erosion and Profit Shifting Project, published on 13th February 2019 (Consultation Document 2019), para 29 – 49, p.11 – 16.

[189] *OECD,* Public Consultation Document, Addressing the Tax Challenges of the Digitalization of the Economy: OECD/G20 Base Erosion and Profit Shifting Project, published on 13th February 2019 („Consultation Document 2019"), para 29 – 49, p.11 – 16. para 29 p.11, para 42 p.14, para 60 p.18, para 67 p.19.

establishment threshold and possibly allocate profits to market countries on a formula basis; this approach has been spelt out by the G-24 group of emerging and developing economies[190].

1.1 User contribution

User participation is a key criterion for identifying the creation of digital value both in the provision of personal data and in the processing of predictive (profiling) and information products, and in interactions between users. In fact, the behavioural surplus of digital companies derives precisely from the regular, systematic and habitual appropriation of personal data. In addition, the active participation of the user capitalises the *brand equity* and market power of the economic agent[191].

User therefore means market power and economy of scale and its participation is a specific manifestation of the ability to contribute to the enterprise. In fact, the first draft tax that highlights the centrality and the user's prominence in the creation of digital value, namely that relating to the EU DST involves: the services of transmission of personal data recompiled, active participation in brokering services and participation in social networks that allow the exchange of goods and services between users.

Everything is focused on social platforms, search engines and online markets and confirms the important value of the user's contribution in business. Consequently, digital services should be taxed at the place where the users are located and the link cannot be the physical or material presence, but the significant economic activity exercised in the market jurisdiction that can be identified as the value created by the users. Data and users represent unique intangibles, sources of value that must necessarily be evaluated during the allocation of business profits.

The OECD therefore proposes to change the residual allocation method (*residual profit split*) and to ensure that the value of users and users in each country is treated as

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[190] G-24 Working Group on tax policy and international tax cooperation, Proposal for Addressing Tax Challenges Arising from Digitalisation, 17th January 2019.

[191] Rosembuj, T. (2018). *Inteligencia artificial e impuesto*. Barcelona, pp. 116 ss.

business profits. This would be a radical change in tax rights and, in particular, a shift of the tax link from the company's State of residence to the market jurisdiction where the user is located.

The *residual profit split method* identifies two types of profit to be attributed: *routine profits* and *residual* or *excess profits*. The former are the ordinary revenues derived from the investment, while the latter constitute the *behavioural surplus* obtained thanks to the unique intangibles (personal data and predictive products). After the allocation of the *routines profits*, we proceed with that of the *residual profits* which, according to the proposed reform, should take into account the value created by the user's participation in the market jurisdiction, especially in the case of certain digital activities.

The *Modified Residual Profit Split method* allocates portions of a multinational enterprise's non-routine profits to a market jurisdiction. It is similar to the *Marketing Intangibles* proposal, but it eliminates the distinction of a Marketing Intangible entirely. It generally involves four steps:

(i) determine the total profit that must be split;

(ii) extract routine profits from non-routine profits;

(iii) determine the certain in-scope non-routine profits that should be allocated; and

(iv) allocate such in-scope non-routine profits to the relevant market jurisdictions, which is determined by an allocation key.

In this way the excess income would be taxed in the State in which it is generated: "the *modified residual allocation method* would allocate to the market jurisdiction a portion of the non-routine profits of the multinational group, which reflects the value created in the markets that is not recognised under the applicable rules on profit allocation"[192].

Until now, neither a full nor a partial allocation of taxing rights to market countries on the basis of the distinction between *routine profits* and *residual profits* has been accepted by production countries given their clear fiscal interests. But when we look at

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[192] OECD – G20, 2019. Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy.

the proposals[193] currently on the table of the Inclusive Framework/OECD with respect to the digitalized economy, there is a tendency to establish additional qualitative and quantitative thresholds for source taxation which further narrow the scope of market countries' rights to encroach upon the business profit tax base traditionally tapped by production countries.

1.2 Marketing intangibles

Similar to the user participation proposal, this proposal distinguishes between multinational enterprises' non-routine or residual profit from routine profit, and would modify current profit allocation and nexus rules to allow market jurisdictions the taxing right over certain non-routine profits, regardless of physical presence. However, this proposal requires the division of non-routine profit into that attributable to market intangibles[194] and that of trade intangibles, derived from any other revenue obtained from ordinary production intangibles (licenses, copyright, know-how).

The OECD considers marketing intangibles brands, trade names, commercial exploitation of the good or service, customer lists, distribution channels, symbols and designs that have promotional value for a certain product. The intangible, in the strict sense, is the creation of value in the business activity associated with the consumer and the customer. Therefore, the return on *marketing intangibles* depends on the amount of investment that is made for advertising purposes: the higher the expenditure aimed at persuading the consumer, the higher the return on scale.

The proposal focuses on economic activity linked to the customer base of a

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[193] *OECD,* Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note, As Approved by the Inclusive Framework on BEPS on 23 January 2019: OECD/G20 Base Erosion and Profit Shifting Project, 2019 (Policy Note 2019).

part 1.2.

[194] The OECD defines the term Marketing Intangible as "*an intangible. . that relates to marketing activities, aids in the commercial exploitation of a product or service and/or has an important promotional value for the product concerned. Depending on the context, marketing intangibles may include, for example, trademarks, trade names, customer lists, customer relationships, and proprietary market and customer data that is used or aids in marketing and selling goods or services to customers.*" OECD TRANSFER PRICING GUIDELINES FOR MULTINATIONAL ENTERPRISES AND TAX ADMINISTRATIONS 27 (2017).

jurisdiction. In this way, the residual profits of marketing, promotion, advertising and brand equity will be taxed in the market jurisdiction, while other profits and income from intangible production would be subject to the applicable transfer pricing rules (at arm's length).

When it comes to the technique of profit allocation, the "*marketing intangible*" approach reiterates the afore-mentioned distinction between routine profits and residual profits, which is advocated by a number of scholars as a general approach to the international allocation of taxing rights. The marketing intangible approach pleads for an allocation of the routine profits to traditional source jurisdictions and all or part of the "residual profit" to the market country[195]. But it is more restrictive than the afore-mentioned academic proposals on *Residual Profit Split* and *Residual Profit Allocations* as it further requires the identification of such "*marketing intangibles*" (as opposed to mere "trade intangibles" like patents or copy- rights). Moreover, one would probably have to distinguish between *marketing intangibles* created for a specific market as opposed to global branding activities of a firm[196].

This link between allocating taxing rights and allocating profits is incoherent. It would be a fallacy to assume that the residual profit is – in practice or in theory – fully or partially identical or correlated with the return allocable to one or more marketing intangibles in the first place[197]. The residual profit earned by an enterprise is the premium on the overall risk of the multinational firm, which goes beyond the sum of all routine profits allocable to individual business units. Moreover, it reflects synergy rents from the interaction between the different parts of the enterprise. It therefore rather represents the overall "good will" of the corporate group[198] and not the sum of the values of the specific market-related and product-related intangibles.

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[195] *OECD,* Public Consultation Document, Addressing the Tax Challenges of the Digitalization of the Economy: OECD/G20 Base Erosion and Profit Shifting Project, published on 13th February 2019 (Consultation Document 2019), par. 32, para 43 – 48, para 73 – 79.

[196] *OECD*, Consultation Document 2019, para 61 p.18.

[197] I*tai Grinberg,* International Taxation in an Era of Digital Disruption: Analysing the Current Debate, Taxes, March 2019, pp. 87 and ss.

[198] *Paul Oosterhuis, Amanda Parsons*, Destination-Based Income Taxation: Neither Principled Nor Practical?, 71 Tax Law Review (2018), p. 532.

If one had to allocate the residual profit of a multinational enterprise under conventional transfer pricing practice, the residual profit would possibly go to the country where the major "entrepreneurial" decisions are taken, not where some valuable IP rights are administrated. On the other hand, any return on a specific "marketing intangible" should reflect the value of this intangible and the contribution of this intangible to the overall market success of the firm. This return might be higher or (presumably) lower than the overall residual profit of the firm[199].

From a more foundational perspective, the "marketing intangible" approach is linked to the traditional concept of the corporate income tax as a tax on capital income. The corporate profit represents essentially the return on invested capital and this investment goes into intangibles offering benefits in a specific market[200]. Unlike under the "user contribution" proposal, under the "marketing intangible approach" it is not the users that create the relevant value; it is the firm itself and its "*activities targeted at customers and users in the market jurisdiction*"[201]. This "*active intervention of the firm in the market*" can also be distinguished from "*favourable demand conditions that exist independent of the actions of the firm*". The Consultation Document therefore very clearly refers to online businesses which "*invest successfully into a foreign market, develop a broad customer base, and create value that would have typically required some physical proximity and a local presence*"[202].

It is interesting to see that the marketing intangible approach as laid out in the Consultation Document mixes the traditional perspective on transfer pricing and the residual profit allocation perspective when it comes to the question of how to split the "residual profit" between production countries and market countries.

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[199] Wolfgang Schön, "*One Answer to Why and How to Tax the Digitalized Economy*", June 2019.

[200] *OECD,* Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, 2018, par. 34.

[201] *OECD,* Public Consultation Document, Addressing the Tax Challenges of the Digitalization of the Economy: OECD/G20 Base Erosion and Profit Shifting Project, published on 13th February 2019 (Consultation Document 2019), par. 31, p. 12.

[202] *OECD,* Public Consultation Document, Addressing the Tax Challenges of the Digitalization of the Economy: OECD/G20 Base Erosion and Profit Shifting Project, published on 13th February 2019 (Consultation Document 2019), par. 39, p. 13.

There are, however, some criticisms related to the application of this method. The first concerns the separation between marketing intangibles and production intangibles: an operation aimed at determining the residual profit of marketing intangibles which would be arbitrary and subjective. Moreover, the combination of the residual method for marketing intangibles and at arm's length for production intangibles would condemn both to the tax ineffectiveness of the market jurisdiction and this depends solely on the inability of the at arm's length criterion to determine economic activity in the absence of comparable goods or services[203].

The second critical point is the qualification of recipients as consumers, which could hamper the distinction between users who purchase goods and services and those who provide data. The application of different methods for the determination of profits derived from distinct intangibles does not prevent transfer pricing from being manipulated to shift profits to low-tax jurisdictions.

1.3 Significant economic presence

Going beyond the mere existence of a market, a group of emerging and developing economies ("G-24") has put together the concept of "significant economic presence"[204], trying to establish a threshold for source taxation amending the traditional permanent establishment concept under Art. 5 OECD Model Tax Convention.

The notion of a fixed physical presence should be left behind and the concept of ongoing participation in the economic life of a country (and its markets) should replace this nexus rule. While this concept is not exclusively targeted at the digitalized economy, the G-24 make clear that the interaction between a foreign firm and local users via a platform and exchange of data constitutes one major example for this new category of "significant economic presence".

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[203] Avi – Yonah R. S., "*Splitting the Unsplittable: Toward a Formulary Approach to Allocating Residuals Under Profit Split*". (2013).

[204] G-24 Working Group on tax policy and international tax cooperation, Proposal for Addressing Tax Challenges Arising from Digitalisation, 17th January 2019, par. 9.

The European Union, in the DST project, identifies this presence in the profits derived from the provision of digital services, in the number of users or supply contracts. The activities considered, as anticipated, are: the collection, storage, processing, analysis, use and sale of data and content of the user and the sale of online advertising.

According to the OECD proposal, the company's presence should be defined on the basis of factors that "highlight an intentional and complete interaction with the jurisdiction through digital technologies and other means of automation"[205] and indicators such as local currency invoicing and collection, maintenance of websites in local language, final delivery of goods to consumers, customary marketing activities, advertising and sales.

The proposal aims to reward market jurisdictions by abandoning the traditional residency-based nexus rules in favour of an economic nexus rule, which includes digital presence. In other words, it adopts a formulary apportionment approach where the tax base is computed by applying the global profit rate of the multinational enterprise group to the revenue generated in a particular jurisdiction, and such base is allocated based on apportionment factors, such as sales, assets, employees, and importantly, users[206].

It targets a wider scope than either of the user participation or marketing intangibles proposals.

The significant presence concerns the wide use of the market and, since its core is the achievement of profits at a distance through the use of data and local users, its form of organization is neither physical nor material (although it does not exclude that there may also be physical or material activities). The novelty of this proposal that bases the link on the "presence factor" is in allowing the attribution of taxable profits by means of a formula of division between jurisdictions: *apportionment formula* or *fractional apportionment method*.

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[205] *OECD,* Public Consultation Document, *Addressing the Tax Challenges of the Digitalization of the Economy*: OECD/G20 Base Erosion and Profit Shifting Project, published on 13th February 2019 (Consultation Document 2019.

[206] G-24 Working Group on tax policy and international tax cooperation, Proposal for Addressing Tax Challenges Arising from Digitalisation, 17th January 2019, par. 15; *OECD,* Public Consultation Document, Addressing the Tax Challenges of the Digitalization of the Economy: OECD/G20 Base Erosion and Profit Shifting Project, published on 13th February 2019.

The fractional apportionment method does not distinguish between routine and non-routine profit. Rather, this method envisages an agreed upon metric to determine the total amount of profit to be divided, and then certain formulas/allocation keys that will allocate the profit to the relevant market jurisdictions.

This method represents a clear and decisive alternative to the at arm's length approach in determining the consolidated and uniform profits of the multinational company. In concrete terms, this method would generally consist in three steps:

(i) determine the profit to be allocated;

(ii) select an allocation key; and

(iii) apply the formula to determine the profit allocated to the market jurisdiction.

The factors in the formula may include employees, assets, sales and users.

India, which will be better analysed in the next chapter, has designed a "fractional allocation formula" based on information about operations carried out in its territory. In this way, due to the obvious difficulties related to finding cross-border information, India avoids the consolidation of the accounts of the foreign company. "It takes into account the contribution of supply and demand to the income of the undertaking and therefore reasonably allocates profits in the jurisdiction in which the consumers and the market are located, the one in which the inputs are located and the one in which supply-side activities are carried out"[207].

The formula is based on three factors that assume the same (30%) reluctance during the evaluation: sales, labour and assets. In addition, it provides for the application of a user factor for a more precise determination of the business activity. The weight of this factor is of 10%, but it can also reach 20% if it is found that the contribution of the customers to the enterprise activity has been particularly consisting. In this case, the labour factor and the assets factor are proportionately reduced, while the sales factor remains unchanged.

It should be also mentioned that since 2018 India has accepted in its legal legislation the concept of economic presence signifying the non-resident, which applies whenever the

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[207] Government of India. Public Consultation on the proposal for amendment of Rules for Profit attribution to Permanent Establishment. (2019).

foreign company exceeds a certain number of transactions (digital and non-digital) on the territory, if it interacts digitally with a certain number of users, if it uses digital means for the systematic and continuous realization of its economic activities.

2. Second Pillar. Protection of the tax base.

The second pillar is an evolution of the common BEPS principle on the protection of each country's tax base. It allows each State to determine its level of tax protection, but only on condition that income is subject to an effective rate not lower than the minimum rate applied by the other States. Thus, on one hand, jurisdictions are allowed to tax profits deriving from economic activities carried out in their territory, on the other, the use of tax power to attract investments, savings and capital is prohibited.

The overall anti-erosion proposal of the OECD tax bases is aimed at reinforcing the principle of tax protection and the elimination of harmful tax competition.

The proposal is based on two basic principles. The first principle is the income inclusion rule and has the task of taxing the income of the branch or subsidiary that has been subject to a low effective rate in the country of residence. This principle is similar to that laid down in the Controlled Foreign Corporation (CFC) rules.

The second principle is that which prohibits the erosion of the tax base and consists in the failure to grant the deduction, in the taxation at source, to ensure that certain payments are subject to a rate higher than or equal to the minimum set (undertaxed Payments rule).

These principles go beyond digitalisation in the strict sense. Their scope of action covers the whole area of economic activity and, in particular, the intangibles used to shift profits to low-tax jurisdictions, be they marketing, production or any other type. The proposal was certainly influenced by the *US Tax Cuts* and *Jobs Act* of 2017. The US law that introduced the *Global Intangible Low Taxes Income* (GILTI) and the *Base Erosion and Anti-abuse Tax* (BEAT).

The GILTI, like the principle of income inclusion of the OECD, attributes the non-taxed or low-taxed income of a foreign affiliated enterprise to the resident parent

company and makes it subject to a 10.5% tax rate[208]. This income, consisting of the total active income of the affiliated company that exceeds 10% of the tangible assets depreciable of the parent company, is incorporated into the annual gross income of the latter and taxed in order to discourage the shift of profits derived from intangibles to low-tax jurisdictions.

The BEAT treats deductible payments (such as interest, royalties) made by the US-based company to affiliated companies. Its operation is based on the comparison between the tax paid by the resident company on the basis of the ordinary rate of 21% and the BEAT tax, calculated by including in the tax base the deductible payments made to affiliated companies and applying a rate of 10% (from the tax year 2019). If the tax paid by the resident company is lower than the BEAT tax, the latter will have to pay to the State the difference between the two amounts.

The two measures adopted unilaterally by the United States do not take into account the fact that a minimum rate is applied in foreign jurisdiction, contrary to what is proposed by the OECD. However, they open the way to a new approach to combating profit displacement and harmful tax competition. This is the prediction of a global minimum. The latter seems to be one of the key instruments with which the tax problem of digitisation will be addressed in the future.

3. The unified approach: the latest OECD proposal for the first pillar

Last October the OECD launched a new proposal: the "*Unified Approach*" of the first pillar alternatives (OECD, 2019b). The aim of this work programme is to find a solution which will enable the various positions on digital taxation to be agreed, highlighting the similarities between the three options of the first pillar:

- all the proposals would reallocate the right of taxation to the jurisdiction of the user/market, because they recognise that highly digitalized companies are able to operate at a distance and/or have a high economic power;

[208] Pomerleau, K., 2019. *GILTI | Global Intangible Low-Taxed Income (2019)*. [online] Tax Foundation. Available at: <https://taxfoundation.org/gilti-2019/> [Accessed 18 April 2020].

- all proposals include a new rule of the link that would not depend on the physical presence in the jurisdiction of the user/market;
- they all go beyond the arm's length principle and depart from the principle of the separate entity;
- they are all in search of simplicity, of stabilizing the tax system and of increasing fiscal certainty.

The proposal covers highly digitalized business models, but is increased in scope to include consumer-facing businesses. The Unified Approach creates 1) a new nexus rule, not dependent on physical presence and instead largely based on sales, and 2) a new profit allocation rule using a formulaic approach to determine a share of residual, or non-routine, profit allocated to market countries.

The Unified Approach creates a three-tier mechanism for apportioning a multinational's profits into various countries:

- amount A: this method would redistribute part of the alleged residual profit of a multinational company to the market jurisdictions, regardless of the place and/or residence of that company. In general terms, this approach would reproduce both the characteristics of the residual profit allocation method (introducing a profitability threshold to exclude routine profit) and the split allocation method (according to a formulary apportion). The starting point for the determination of the amount A would be the identification of the profits of the multinational group. The second step would approximate the profit routine on the basis of an agreed profitability threshold. Profits in excess of the agreed profitability threshold would be considered as non-routine group profits and should be broken down between the market jurisdiction. Non-routine profits derived from customer data and/or brand name, i.e. other own factors of the enterprise, such as trade intangibles and capital, including innovative algorithms and software. The final stage of the proposed approach would be to allocate the relevant part of the non-routine profit among the appropriate market jurisdictions according to distribution formulae based on specific variables, such as sales;
- amount B: consists of a fixed amount of remuneration for marketing and

distribution activities on the territory, considered as a routine profit and therefore subject to the current rules on transfer prices and at arm's length;

- amount C: conflict prevention and resolution mechanism, which allows the inclusion of any additional profit by applying transfer pricing rules and at arm's length – amount C-, when the functions in the territory exceed the activity of marketing and distribution and when conflicts arise between the excess profits claimed by the juridical market and the amount of fixed remuneration defended by the multinational company.

This programme maintains the current transfer pricing regime and at arm's length for marketing intangibles, which would be taxed as ordinary generators of benefits awarded on the basis of a fixed amount of remuneration. The OECD does not understand that it is impossible to separate the profits derived from marketing and distribution from the rest of intellectual capital (trade intangibles).

Besides, there is no convincing explanation justifying the existence of transfer pricing and arm's length rules that prevent the attribution of excess profits to market use.

Not even the separation of residual profit between the company and market jurisdiction is able to provide the proposal with a glimmer of reasonableness. In fact, it ignores that the creation of value depends on the user - and not on the algorithm or the software - and that his participation determines the non-residual excess profit. The distribution formula must be total and based on the same factors adopted by India and the European Union in the CCCTB project.

Finally, it should also be stressed that the mechanisms for resolving conflicts relating to the allocation of profits go in a completely opposite direction to the simplification and fiscal certainty pursued by the OECD.

CHAPTER III

UNILATERAL PROPOSALS. A COMPARATIVE ANALYSIS

As reported by the European Commission in the Communication COM (2017) 547, it is necessary that the States find an agreement that "allows to obtain and promote ambitious results", able to establish the tax bases of each country and ensure the pursuit of fair competition within the single market; at the same time, the European Union must examine all the proposals to introduce new rules concerning the taxation of the digital economy within its territory, to counter aggressive tax policies and increase transparency, respecting the objectives of fairness, competitiveness, single market integrity and sustainability[209].

In addition, a common action allows to strengthen the European position in international discussions to achieve significant progress and developments, ensuring a consistent approach and not a fragmentation of the Single Market, which leads to increased uncertainty and destabilisation[210].

Strong pressure to find an international solution to the taxation of the digital economy stems from the fact that more and more countries are taking unilateral measures. The spread of such initiatives causes complexity and economic distortions in international transactions, causing effects opposite to those towards which international corporate taxation rules would like to aim: avoiding double taxation, promoting international trade, and stimulating economic growth.

There is a need for a common discipline, because if each State promulgated its own legislation to ensure the taxation of the digital economy, without worrying about what is in place in other legislatures, a company operating in different territories would risk being subject to multiple taxation, since each is entitled to exercise its power of sovereignty.

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[209] Commission Communication COM (2017) 547, *'A fair and efficient tax system in the European Union for the Digital Single Market*', 21 September 2017.

[210] European Commission, Questions and Answers on the Communication on a Fair and Efficient Tax System in the EU for the Digital Single Market, 21 September 2017

Therefore, it is necessary to find a compromise capable of satisfying conflicting interests: on the one hand, there is the need to guarantee the right of sovereignty of each individual country and the tax compliance of elusive companies, but on the other hand to maintain neutrality in the tax system in order to avoid burdensome behaviour to the detriment of companies and to abolish cross-border discrimination[211].

At the moment, however, Member States are not yet in a position to share and approve a common position, since there are divergent interests that have led to a break-up traditional and uniform consensus, resulting in the issuing of multiple unilateral initiatives[212].

Some countries, in fact, have proposed and in some cases already implemented national measures to solve the problem of the erosion of the tax base, without waiting for the consent of the other legislations, while in other cases the planned solutions have not yet been adopted.

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[211] Schon W., *Neutrality and Territoriality – Competing or Converging Concepts in European Tax Law?*, in "Bulletin for International Taxation", n. 4, 5, 2015, p. 274

[212] Panay C., "*International Tax Law Following the OECD/G20 Base Erosion and Profit Shifiting Project*", in "Bulletin for International Taxation", n. 11, 2016, p. 628

SECTION 1

1. The UK and the "Diverted Profit Tax"

Despite the never-silent preference of the EU bodies (and many state administrations) for a common and shared approach, a number of European (and other) States, as easily predicted, have not remained inactive and have, on the contrary, given implementation to the most disparate mechanisms in the attempt to displace the artificial shifting of the incomes operated from web companies.

The shared, as well as urgent, need to find innovative tools capable of forcing "digital multinationals to pay to State administrations a fair share of taxes" by ensuring that such a payment was made in the jurisdictions where the production and sale of services was actually carried out, has led to state proposals based on considerations which, up to that point, departed substantially from the principles of international taxation adopted by the OECD countries[213].

The clearest example is British law enforcement to tackle the diversion (for this reason "Diverted Profit Tax") of income to low-tax countries.

The main objective of the Diverted Profit Tax is neutralizing the schemes used by big companies that cause the erosion of the tax base in the UK, avoiding their taxable presence.

In fact, after considering unsatisfactory the clarifications provided by Google and Amazon regarding their respective tax strategies[214], the UK thought it should resolve these issues ex auctoritate, studying new legislation with the specific purpose of preventing web companies that carry out their business activities in the United Kingdom

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[213] Gallo F., "*Prospettive di tassazione dell'economia digitale*, in *Diritto Mercato Tecnologia*", n. 1/2016, p.162.

[214] The 2013 PAC (Public Accounts Committee) survey of Google, which was invited to provide further oral evidence to the committee to justify: "*the deeply unconvincing argument that its sales to UK clients take place in Ireland, despite clear evidence that the vast majority of sales activity takes place in the UK. [...] Big accountancy firms sell tax advice which promotes artificial tax structures which serve to avoid UK taxes rather than to reflect the substance of the way business is actually conducted."(Public Accounts Committee,* 2013).

from diverting profits to foreign countries, or making sure that the right amount of taxes is paid to British administrations[215].

Since April 2015, in fact, the so called "Diverted profit Tax", introduced through the Finance Act of the same year, applies to two different hypotheses.

The first is where a non-resident company makes sales or, in any event, makes significant transactions in the United Kingdom without the establishment of a permanent establishment on the spot. In particular, it requires the existence of at least one of two specific conditions, respectively called "tax avoidance condition" and "mismatch condition". The first of these conditions can be considered integrated when the main purpose, or one of the main purposes, of the operation is to circumvent the British corporation tax. The second condition is a situation of "effective tax mismatch outcome" - which occurs when the foreign tax applied by the person concerned is less than 80% of the UK tax equivalent - and a situation of "insufficient economic substance", in which, that is, the tax benefit is greater than any other economic advantage and it is reasonable to assume that the transaction was devised in order to achieve a reduction in the tax burden. In such a case, the UK framework gives the Finance Administration the power to verify whether economic activities related to the supply of goods and services to resident customers have been structured in such a way as to circumvent the creation of a permanent establishment. If the tax administration of the United Kingdom considers that such arrangements have actually been put in place without a valid economic reason and, consequently, have the avoidance and erosive intent of the tax base, it shall issue an administrative act setting out the reasons for which the administration considers Diverted Profit Tax should be applied, as well as an invitation to the company to submit appropriate explanations[216].

The second case in which the "Diverted profits Tax" applies is a resident company or a non-resident company which carries on an activity for which it is subject to tax in the

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[215] Gallo F., "*Prospettive di tassazione dell'economia digitale*", in *Diritto Mercato Tecnologia*, n. 1/2016, pag.163.
[216] Gallo F., Prospettive di tassazione dell'economia digitale, in "*Diritto Mercato Tecnologia*", n. 1, 2016, p.164.

United Kingdom but enjoys a tax advantage resulting from the use of agreements or third parties without economic substance, which obviously recalls the second of the conditions outlined above. The latter hypothesis of application of the tax on profits subtracted is that in which a company not resident in the United Kingdom evades the creation of a permanent establishment (Non-UK company avoiding a UK taxable presence) despite the accomplishment of significant transactions in the relevant jurisdiction[217]. In general

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[217] See *Finance Act* in Art. 86*:" Non-UK company avoiding a UK taxable presence: (1) This section applies in relation to a company ("the foreign company") for an accounting period if— (a) the company is non-UK resident in that period, (b) it carries on a trade during that period (or part of it), (c) a person ("the avoided PE"), whether or not UK resident, is carrying on activity in the United Kingdom in that period in connection with supplies of services, goods or other property made by the foreign company in the course of that trade, (d) section 87 (exception for companies with limited UK-related sales or expenses) does not operate to prevent this section applying in relation to the foreign company for the accounting period, (e) it is reasonable to assume that any of the activity of the avoided PE or the foreign company (or both) is designed so as to ensure that the foreign company does not, as a result of the avoided PE's activity, carry on that trade in the United Kingdom for the purposes of corporation tax (whether or not it is also designed to secure any commercial or other objective), (f) the mismatch condition (see subsection (2)) or the tax avoidance condition (see subsection (3)) is met or both those conditions are met, (g) the avoided PE is not excepted by subsection (5), and (h) the avoided PE and the foreign company are not both small or medium-sized enterprises for that period. (2) "The mismatch condition" is that— (a) in connection with the supplies of services, goods or other property mentioned in subsection (1)(c) (or in connection with those supplies and other supplies), arrangements are in place as a result of which provision is made or imposed as between the foreign company and another person ("A") by means of a transaction or series of transactions ("the material provision"), (b) the participation condition is met in relation to the foreign company and A (see section 106), (c) the material provision results in an effective tax mismatch outcome, for the accounting period, as between the foreign company and A (see sections 107 and 108), (d) the effective tax mismatch outcome is not an excepted loan relationship outcome (see section 109), (e) the insufficient economic substance condition is met (see section 110), and (f) the foreign company and A are not both small or medium-sized enterprises for the accounting period. (3) "The tax avoidance condition" is that, in connection with the supplies of services, goods or other property mentioned in subsection (1)(c) (or in connection with those supplies and other supplies), arrangements are in place the main purpose or one of the main purposes of which is to avoid or reduce a charge to corporation tax. (4) In subsection (1)(e) the reference to activity of the avoided PE or the foreign company includes any limitation which has been imposed or agreed in respect of that activity. (5) The avoided PE is "excepted" if— (a) activity of the avoided PE is such that, as a result of section 1142 or 1144 of CTA 2010, the foreign company would not be treated as carrying on a trade in the United Kingdom in the accounting period through a permanent establishment in the United Kingdom by reason of that activity, and (b) in a case where— (i) section 1142(1) of that Act applies, but (ii) the avoided PE is not regarded for the purposes of section 1142(1) of that Act as an agent of independent status by virtue of section 1145, 1146 or 1151 of that Act,the foreign company and the avoided PE are not connected at any time in the accounting period. (6) Where the foreign company is a member of a partnership— (a) for the purposes of subsection (1)— (i) a trade carried on by the partnership is to be regarded as a trade carried on by the foreign company, and (ii) supplies made by the partnership in the course of that trade are to be regarded as supplies made by the foreign company in the course of that trade, and (b) for the purposes of subsection (2)(a) provision made or imposed as between the partnership and another person is to be regarded as made between the foreign company and that person. (7) In this section "arrangements" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable)."* (*Finance Act* 2015).

terms, however, the rule may be applied to non-resident companies that have activities in place to supply goods and services to users resident in the UK, if: "it is reasonable to assume that any of the activities carried out by the permanent establishment that you are trying to hide or by the non-resident society (or both) was also designed to ensure that the non-resident company did not carry out that transaction in the United Kingdom in order to avoid the application of corporate tax (regardless of whether it has been set up for some other objective, economic or not)"[218].

In these two cases, the British Financial Administration - after having conducted an adversarial phase with the company concerned - may issue a notice of establishment and subject to taxation the profits which the same Administration deemed to have been deducted from taxation with a tax rate of 25%, increased compared to the ordinary British "corporate income tax"[219].

The compatibility of this form of taxation with the double taxation conventions and the fundamental freedoms guaranteed by the European Treaties can be questioned. As for the former, it could be argued that the Diverted profits Tax is not structured as an income tax and, therefore, could be considered excluded from the objective scope of application of international conventions[220].

Add to this the further consideration that the Diverted profits Tax aims, in the final analysis, to counter structures without economic substance, abusive, to which, as such, conventional benefits should not be guaranteed[221].

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[218] *Uk Government, Finance Act*, 2015, art. 86 paragraph 1 lett. e).

[219] Persiani A, "*Imposizione diretta, economia digitale e competitività tra Stati"*, in *Diritto Mercato Tecnologia*, 1/2016, pp. 186 ss.

[220] See Rosembuj T., "*Taxing Digital*", Barcellona, 2015, p. 197.

[221] See, in this regard, par. 9.4. of the «*commentary to art. 1 of the OECD model of the double taxation convention» where it states that «it is agreed that States do not have to grant the benefits of a double taxation convention where arrangements that constitute an abuse of the Provisions of the convention have been entered into*». There is also a further consideration specifically related to the UK legal system, in which international conventions are in themselves not self-executing and, as such, shall not give rise to private individuals' rights which may be invoked directly against the English State. An internal standard is therefore required that attributes direct vertical effects to the conventions; a rule that was issued in 2010 with reference to taxes on income, on "*capital gains*" and the "*petroleum revenue tax*" and which is doubtful can be enacted with reference to the «Diverted profits Tax». See D. Neidle, *The diverted profits tax: flawed by design*? in *British Tax Review*, 2015, p. 164-165.

As for the relationship with the discipline dictated by the TFEU, here too it is necessary to consider the purpose of the Diverted profits Tax of contrast of not genuine structures and, therefore, the possibility, far from remote, to consider any discrimination or restrictions that may arise from the Diverted profits Tax, justified by the objective of combating artificial constructions and ensuring taxation in accordance with the principle of territoriality; and we cannot ignore the evolution of European Union law towards the contrast of those companies that - even if they cannot define themselves as real "letter box companies", however, having a minimum of economic structure - show, nevertheless, such indices as to make them consider inadequate in relation to the performance of their activities[222].

In conclusion, although the UK Diverted Profit Tax is not explicitly directed at the taxation of digital companies, it can also have a significant impact on them, as the latter have, very often, the characteristics set out in that forecast. In addition, in the UK there is also the introduction of a rate of 2% on revenues from digital services rendered by search engines, social media and online marketplace, intended to affect only very profitable companies, capable of achieving at least GBP 500 million in worldwide turnover for digital services[223].

1.1 Analysis and main innovations introduced by the DPT

It should be noted that the taxable event is configured around tax avoidance, or, in a similar wording, around the concept of abuse of law.

The circumvention is created by means of technical procedures, legal businesses, and legal acts, and exclusively for tax purposes or for the principal purpose of minimizing the tax that should have been paid.

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[222] See the EU Council Resolution of 8 June 2010 on the coordination of rules on foreign subsidiaries and on under-capitalisation in the European Union, in Official European Union Journal 156 of 16 June 2010, pp. 1 ss.

[223] Marè M., "*La UE deve attuare una linea comune", Il Sole 24 Ore,* 11 June 2019.

Frequently, the quantification of the tax base, in the case of sales within the territory, is based on the fair and reasonable profits that could be determined if the transactions were made through the avoided PE. Hence, the State-less income becomes a requirement of the chargeable event and, therefore, a display of ability to pay granted by the territory in which is verified.

Moreover, the tax on diverted profits cannot be assimilated to the classic Corporate Income Tax, because it is not a taxation on the net income of the taxpayer arising from its economic activity, but on the avoidance of profit that should have been levied. It is essential, therefore, to differentiate the Corporate Income Tax from the DPT: they are different in purposes, taxable event, tax base and objectives. The DPT aims to affect the harmful tax competition among States and not the fair competition[224].This entails a different scope from the perspective of international taxation, considering that the DPT is not an income tax, because if it were an income tax and it were confirmed by the reconstruction of the taxable event, it would fall outside the scope of the OECD Model Convention aimed at avoiding the double taxation. If the tax is not equivalent or similar to Corporate Income Tax, it does not violate any international agreement.

In addition, it should be noted that in the event of circumvention of permanent establishment in the UK, the "mismatch condition", disparity or asymmetry of the tax, occurs whenever transactions costs increase or reduce the income of a related entity and the other party pays less that 80% of the reduction resulting from the transactions of the first entity. The practical scheme also gathers two requirements: the insufficiency of economic substance of operations performed and the main purpose of avoiding Corporate Income Tax. It is worth noting that the notion of economic substance matches the objective definition of the US law: the financial benefit of the tax reduction is superior to all the profits obtained from the operation or operations; thus it can be deduced that they were planned in order to achieve the tax relief.

As stated above, the second assumption involves a resident enterprise and a non-resident related company or a foreign company with permanent establishment in the UK,

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[224] Rosembuj T., "*Taxing Digital*", in *El Fisco*, 2015, pp.193 ss.

which conclude artificial transactions among them, lack economic substance and, as in the first assumptions, raise more outflow or less tax and therefore a zero tax in the related group. Here the economic substance is absent in both subjective aspects and aim (the obtained profit does not belong to the transaction but to the tax minimization)[225].

Finally, the DPT does not dispute principles and economic freedoms, but the right to safeguard and protect the tax base of each State. The British tax fighting tax base erosion and profit shifting does not restrict the fundamental right of doing business in a single market, but the aggressive tax planning and the abuse of law which the same EU condemned in its provision on tax evasion, tax fraud and harmful tax competition.

2. The Indian Equalization Tax

Among the unilateral solutions adopted by the various countries, the equalization tax introduced by India with the financial law of 2016 also deserves attention.

This equalization tax has taken on the characteristics of a tax on payments received by non-resident companies (without a physical or material presence in India) in exchange for the provision of digital services which can be used on Indian territory. In the present case, the tax is levied on any service related to online advertising that is traded from company to company, including those that depend on the collection, from the processing of personal data of local users and from the storage of digital and virtual goods to final consumption.

The regulatory framework refers to:

- online advertising or any other service, right or use of online advertising software, including radio or television advertising;
- digital advertising space;
- design, creation and maintenance of websites online;
- collection or processing of data relating to online users in Indian territory;
- development or maintenance of online participatory networks,

[225] The obtained profits do not belong to the transaction but to the tax minimization.

- any installation or service of sale of goods or services online;
- use or right of use or download of online music, online movies, online games;
- online news, online search, online maps or GPS applications.

The consumption by the resident taxpayer of the digital goods and services mentioned is indispensable to identify the subject of tax. This however does not make the Indian equalization tax an excise. In fact, the local buyer, enterprise or permanent establishment that declares its taxable income in India, is not the taxable person of the tax, but a substitute that deducts the equalization tax from the price of the service required and then transfers it to the Treasury. Thus, the equalization tax is very similar to a withholding tax, but it would be more appropriate to define it as a withholding tax since it consists of a definitive levy with a fixed rate of 6%[226]. Another essential element for the application of the Indian equalization tax is the financial compensation because if there is no payment, it is assumed that there was not even the service that legitimizes the tax claim[227].

The free services remain therefore outside from the tax field and therefore the equalization tax, having to renounce to this important source of surplus behavioural, loses some of its effectiveness. The tax cannot hit the "two-ways platforms" such as Google or Facebook who, after getting free data from users, sell them on the digital advertising market for the production of predictive products.

The Indian government argues that the equalization tax is not an income tax, so it is automatically excluded from the conventions to avoid double taxation, from the application of transfer pricing rules and the abuse of rights.

But the juridical nature of this tax is a common subject of debate on the part of Indian and the international doctrine. Its characteristics, purpose and modus operandi suggest that it is a tax on gross income that affects digital companies without a permanent

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[226] Rosembuj, T. (2018). "*Inteligencia artificial e impuesto*", Barcelona, p.70-74.

[227] The Indian ET shall be limited to taxing payments made for intangible services provided by the foreign company, including payments for use or right to use any intangible service, for access to any telecommunications network, provided that the services are received, used or made in India. In this way, they have a connection with India, regardless of whether the payment is made by a resident or a non-resident.

establishment on Indian territory. This statement seems also confirmed by the report of the Ministerial Committee which underlines that the main objective of this tax is to establish a tax burden for companies which, unlike local competitors, can avoid paying all taxes in India. It is clear from the allegation that the measure seeks to reproduce the same tax result that would have occurred if the taxable person had a physical presence in India.

Thus, although it applies to payments made to service providers, it appears rather that the equalization tax is an assumed income tax of non-resident companies selling digital services to Indian companies.

It should also be noted that income from economic activities carried out without a permanent establishment can only be taxed in the country of residence of the undertaking carrying out the activities[228], unless they are the result of international tax evasion, aggressive tax planning or treaty abuse. This is because if there is an economic presence, even without physical presence, nothing prevents the State from taxing the value creation of the economic activity in its territory (BEPS principle on the protection of the tax base).

Based on this latter principle, India is subjecting enterprises without a permanent establishment to the payment of a gross income tax obtained in its territory, but by doing so with an absolute presumption, renounces to neutralise international tax avoidance. The equalization tax fails to prevent non-resident companies from eroding the tax base because it cannot quantify and tax the value they create in India.

The limitation of this tax, therefore, lies in the presumptive determination of taxable income, which prevents the application of a more appropriate tax rate on profits transferred. The reason why the tax base of the equalization tax cannot be corrected or modified is to simplify the collection and management of the tax, but this generates inconsistencies because it makes the equalization tax a direct tax on the supposed income administered however as an indirect tax on specific digital services.

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[228] Article 7 OECD Model Convention to avoid double taxation.

3. Spain

On 25 January 2019, Spain presented the "*Proyecto de Ley del Impuesto sobre determinados servicios digitales*", a draft law on the taxation of digital services which denotes a strong influence of the draft Directive on the proposed DST at Community level. The charge relates to digital services which, in their present form, could not be implemented without the involvement of users. In particular, the services taken into consideration are those of:

- online advertising services;
- online brokering services;
- data transmission services

The chargeable event is the provision of digital services on Spain territory and it coincides with the moment when the company carries out the electronic transactions[229]. Taxable persons are companies that in the previous fiscal year had a net turnover of more than EUR 750 million and a revenue from the provision of digital services in Spain of more than EUR 3 million. The first threshold highlights the huge size of digital taxpayers, their extensive network of users and the huge market power they have. The second threshold limits the application of the tax to cases where there is a significant fingerprint (significant economic presence).

In the case of entities belonging to a group, the income thresholds apply to the whole group. The first will reflect the limits defined by Community legislation for the automatic exchange of information and country by country reporting[230] and international standards adopted for the implementation of Action 13 of the BEPS package. The second threshold will be determined without excluding revenues from the provision of digital services between entities of the same group. If the group exceeds these two limits, all the

[229] Non-taxable income is that derived from: retail e-commerce activities; provision of digital content, communication or payment services; regulated financial services; sales of goods or services for which the supplier does not act as an intermediary.

[230] Council Directive (EU) 2016/881 of 26 May 2016, amending Directive 2011/16 as regards mandatory automatic exchange of information in the field of taxation.

entities under its control will become taxable persons even if they do not exceed the threshold of three million euros[231].

The tax rate is 3% and is applied to an available base calculated by different methods depending on the service provided, to ensure that the income taxed is only that derived from the provision of value-added services provided by users located in Spain.

The explanation that supplements the text of the bill specifies that the tax measure in question is not an income tax or an asset because it does not take into account either the characteristics of the service provider or its contribution capacity. However, given and considered that the large size of the companies highlighted by the income threshold is a key element for the identification and qualification of taxable persons this motivation cannot be considered valid. A more substantiated argument in support of this theory could arise from the finding that, instead of taxing net income or net profits calculated after deduction of expenses like most taxes on income or wealth, this tax subject gross income. Furthermore, it could have been observed that the bill does not provide for a mechanism for the inclusion of the tax on digital services in income taxes[232].

The promoters of this measure argue that it is an indirect tax, but this qualification does not cease to raise doubts, because gross income could make it appear as a direct tax based on an absolute presumption of income or a specific income – the digital income – as happens in the case of the Indian Equalization tax.

4. France. "Taxe sur les services numériques"

The issue of taxation of the income of digital companies has been the subject of many studies and experiments at international level.

Among the systematic studies, the document commissioned by the French Government and issued in January 2013 by Mission d'expertise sur la fiscalité de l'économie numérique, established by Ministry of Economy and Finance and Ministry of

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[231] Rosembuj T., "*La fiscalità digitale nell'Unione europea e la strategia OCSE dei due pilastri*", in *Rivista della Guardia di Finanza*, 1/2020, pp. 43 ss.

[232] However, Spain will not apply the law until there is an international consensus during 2020.

Economic Development and coordinated by Pierre Collin and Nicolas Colin ("Report Collin-Colin").

The Collin-Colin Report affirms the need to "recapture" the right to tax profits produced in the countries of sale. To this end, the Collin-Colin Report states that the most appropriate way of taxing profits are through the levy of direct taxes. It notes that this can only be achieved through coordinated action between States through negotiation and argues that the connecting criterion to attract taxation income generated by non-residents operating in the sector must be identified where the personal data used by operators in the sector. It concludes that negotiations between States should lead to a new definition of "permanent establishment" aimed at locating income in the state where a company operating in the digital sector regularly collects information on users to exploit them economically. Moreover, it states to apply during the conclusion of the negotiations, a tax on the use of personal data through an activity of monitoring of users.

According to the report's authors, this system is the only one that would allow, during a transitional period, the neutrality of the tax to be adopted[233].
Following the European Commission's 2018 proposal (analysed in the previous chapter) France decided to proceed autonomously given the failure to approve the Commission proposal.

On March 2, 2019, in an interview with Le Parisien[234], the Minister of the Economy Bruno Le Maire presents the bill on a national web tax that would tax the giants of the web.

Several important points are analysed in this interview. First of all, the French President speaks of "tax justice", referring to the fact that these large digital companies pay approximately 14 percentage points less tax than European small and medium-sized enterprises.

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[233] Palumbo G., "*Prospettive di una nuova tassazione dell'economia digitale"*, in *Il Fisco*, 44/2017, p. 1 - 4257.

[234] *« Taxer Les Géants Du Numérique, Une Question De Justice Fiscale », Affirme Bruno Le Maire*. [online] Available at: <http://www.leparisien.fr/economie/taxer-les-geants-du-numerique-une-question-de-justice-fiscale-affirme-bruno-le-maire-02-03-2019-8023578.php> [Accessed 18 March 2020].

This tax, following the model of the proposal of the European Commission, will be 3% on sales in France and will not hit users but those large companies with a total turnover in digital activities of 750 million euros worldwide and a turnover, attributable to the use of users located in France, of more than EUR 25 million. This requirement, adds Le Maire, would exempt start-ups from paying this tax. The groups that satisfy these requirements are, in fact, the great giants of the web and are for the most part American companies.

This tax would also apply retroactively from 1 January 2019 and would bring tax revenue of EUR 400 million in 2019 and EUR 650 million in 2022. Le Maire restates that the ultimate aim of this proposal is to finger those platforms that get a commission to connect customers with companies.

Therefore, a company that sells its goods on its website will not have to pay this tax. Instead, Amazon which is remunerated as a digital intermediary between manufacturer/company and customer, will be taxed.

The other areas of activity targeted are advertising and resale of personal data for advertising purposes. In addition, to avoid penalising companies that already pay taxes in France, the amount paid will be deductible from the accounting profit on which the corporate tax is calculated, reducing the tax to a third.

Thus, on 6 March 2019, Le Maire presents the bill containing the web tax. Subsequently, obtained the approval of the House and, therefore, of the Senate, on July 11, 2019 it officially enters into force as the "*taxe sur les services numériques*", later renamed as the "Taxe GAFA"[235].

Digital services will be taxable for French DST purposes insofar as they are provided in France. The criteria for assessing the digital services' nexus to France vary depending on the nature of the services. Thus:

- as regard intermediation services on a digital interface, the service will be deemed to be supplied in France if at least one of the users is located therein or if one of the users' interface accounts is opened from France;

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[235] This acronym is used to indicate web giants such as Google, Amazon, Facebook and Apple.

- concerning targeted advertising services, the service will be deemed to be supplied in France if the user consults the digital interface displaying the targeted advertising through a device located in France. The geolocation of such device may be determined based on its Internet Protocol (IP) address or by any other means;
- about the sale of users' data for advertising purposes, the sale will be deemed to take place in France if the data have been generated by a user located in France.

4.1 Analysis and critical features of the TSN

The TSN has been criticised from various aspects. The introduction and the application of it may give rise to difficulties for the relevant enterprises, in particular: the thresholds are based on the turnover realised during the calendar year, whereas the fiscal years of many foreign or French companies are not aligned to the calendar year; information of users may be difficult to collect and finally, it may be difficult to identify the portion of the services which fall in the scope of the Tax, in particular for cross-border transactions.

From a legal point of view, the tax could be challenged based on several arguments.

The tax could be considered as discriminatory in the case of the small enterprises generating revenue below the above mentioned thresholds on one hand, and the big businesses falling within the scope of the Tax on the other. Moreover, the tax could be viewed as incompatible with freedoms guaranteed by the Treaty on the Functioning of the European Union (TFEU), in particular freedom of establishment (Article 49) or freedom to provide services (Article 56). Indeed, as a result of the thresholds of minimum revenues, most of the enterprises within the scope of the tax are not French ones.

Finally, the tax could infringe double tax treaties signed by France, if it is regarded as a substitute for the corporate income tax (CIT). Indeed, the French government has mentioned that one of the objectives of the tax is to be a substitute for the CIT for certain activities relating to the digital economy.

Some of these criticisms were taken into account by the French Government, which, in examining them, declared the TSN's legitimacy as a new tax.

Among the censures raised against the levy was that of linking it to the category of State aid. First, the TSN, because of its characteristics, cannot be classified as State aid prohibited under Article 107 of the Treaty on the Functioning of the European Union (TFEU). If in 2016 the European Commission sanctioned the Hungarian turnover tax on advertising, it was because of the distortion that its progressive rate caused, favouring some companies to the detriment of others without this selectivity being justified by an objectively comparable difference in the situation, nor by the objective of the tax[236]. The TSN, on the other hand, is based on a single rate of 3%. The thresholds for coverage are due to objective differences between large digital multinationals and other companies.

The importance of the direct and indirect network effects, which provide groups with a strong digital footprint with a clear competitive and economic advantage, places these groups in a situation distinct from other operators that carry out the same activities but without the same network effects, or that have a comparable turnover but which is not derived from taxable activities under the TSN. This was the position of the Council of State[237].

Another criticism regarded the compatibility of the French TSN with the VAT. Article 401 of the VAT Directive of 28 November 2006 prohibits Member States from introducing turnover taxes. If, at first sight, this prohibition seems to jeopardize the creation of a national TSN, the latter is well compatible with European law.

Indeed, the prohibition by the VAT Directive of national turnover taxes is intended to avoid jeopardising the common VAT system[238]. It is therefore necessarily based on this objective that the prohibition must be assessed. In this respect, the case-law of the Court of Justice retains a strict definition of the prohibited turnover taxes, which must have the four essential characteristics of VAT, which are cumulative:

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[236] European Commission, Decision (EU) 2017-329 of 4 November 2016 concerning measure SA.39235 (2015/C) (ex 2015/NN) implemented by Hungary in the field of advertising revenue taxation.

[237] Council of State, General Assembly, Opinion on a bill creating a tax on digital services and modifying the trajectory of reduction in corporate tax, 28 February 2019, page 6, points 25-27.

[238] CJCE, 27 novembre 1985, SA Rousseau Wilmot, C 285/84, point 16.

- application “generally to transactions involving goods or services”;
- proportionality “to the price of these goods and services”;
- perception “at each stage of the production and distribution process”;
- application “on the value added of goods and service, the tax due on a transaction being calculated after deduction of the tax paid on the previous transaction”.

The French TSN does not meet at least two of these four characteristics:

- the first feature is missing in so far as the TSN applies only to certain digital services, and not to all economic operations carried out in France
- the fourth feature is not satisfied; the possible impact of the TSN on the consumer depends on the conditions of competition and not on the functioning of the tax[239].

Under these conditions, France can regularly introduce into its legislation a TSN, like other countries, without any objections from the European Commission.

A third criticism was based on the discriminatory nature of the TSN on the grounds of nationality. The risk of a contradiction of the French tax with the rules of international trade was put forward, bacause the TSN would introduce discrimination based on the nationality of the debtors.

First, the system is based on objective and rational criteria. The thresholds of coverage, which follow the logic of the proposal for a Directive, aim to target companies with a large digital footprint, consistent with the TSN’s base insofar as revenues from taxable services are based on the size of that footprint. The national threshold of EUR 25 million is certainly higher than that foreseen by some other countries (EUR 5.5 million for Italy and EUR 3 million for Spain), but its level is precisely aimed at understanding companies with a strong digital footprint not only in the world, but also in France.

Taxable services, too, are undeniably consistent and represent the scope of the proposal Directive.

The fact that many providers should be Americans does not reflect any targeting based on nationality: it is simply a reflection of the economic landscape of digital services.

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[239] CJCE, 3 october 2006, Banco Popolare di Cremona Soc. Coop. Arl, points 32 to 34. See CJCE, 8 june 1999, Erna Pelzl, C-338/97, point 24.

Indeed, large companies providing services in which user participation is the fundamental key are predominantly American.

Moreover, European (including French) and Asian companies, will be directly affected by the TSN, demonstrating the lack of specific targeting of the scheme on the nationality of companies and, incidentally, the reductive and inaccurate nature of "GAFA Tax"[240].

Furthermore, companies may be liable to the TSN because of their membership in a group, rather than an individual exceeding the tax threshold. In this configuration, the number of non-US, and particularly French, companies should be substantially larger than among "direct" providers[241].

It was mainly due to this criticisms that US President Trump announced that they would investigate the possibility that the tax on American digital giants could be a form of unfair commercial practice that could be punished with retaliatory tariffs against France. The U.S. Trade Representative Robert Lightizer was thus ordered to open an investigation based on Section 301 of the 'Trade Act'[242].

In an article are reported the words of Lighthizer, who declares that "The United States is extremely concerned that the Digital Service Tax that should be approved by the French Senate tomorrow may unfairly affect US companies. The President has tasked me

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[240] This designation, stigmatizing the American champions, may have contributed to possible U.S. tensions.

[241] Nationale, A., 2019. *Rapport De La Commission Des Finances Sur Le Projet De Loi, Après Engagement De La Procédure Accélérée, Portant Création D'Une Taxe Sur Les Services Numériques Et Modification De La Trajectoire De Baisse De L'Impôt Sur Les Sociétés (N°1737). (M. Joël Giraud)*. [online] Assemblée nationale. Available at: <http://www.assemblee-nationale.fr/dyn/15/rapports/cion_fin/l15b1838_rapport-fond> [Accessed 15 April 2020].

[242] Title III of the Trade Act of 1974 (Sections 301 through 310, 19 U.S.C.§§2411-2420), titled "Relief from Unfair Trade Practices", is often collectively referred to as "Section 301." Section 301 provides a statutory means by which the United States imposes trade sanctions on foreign countries that violate U.S. trade agreements or engage in acts that are "unjustifiable" or "unreasonable" and burden U.S. commerce. Prior to 1995, the United States used Section 301 extensively to pressure other countries to eliminate trade barriers and open their markets to U.S. exports. The creation of an enforceable dispute settlement mechanism in the WTO, strongly advocated by the United States, significantly reduced U.S. use of Section 301. While the law does not limit the scope of investigations, it cites three types of foreign government conduct subject to Section 301 action: (1) a violation that denies U.S. rights under a trade agreement, (2) an "unjustifiable" action that "burdens or restricts" U.S. commerce, and (3) an "unreasonable" or "discriminatory" action that "burdens or *restricts" U.S. commerce. The statute defines "commerce" to include goods, services, and investment.*

to investigate the effects of this legislation and to determine whether it is discriminatory or unreasonable, whether it harms or limits US trade"[243].

The Office of the United States Trade Representative (USTR) indicated that the French DST unfairly targets certain US-based technology companies. For example, the revenue thresholds in the French DST have the effect of subjecting to the DST larger companies, which tend to be the US companies, while exempting smaller companies, particularly those that operate only in France. Moreover, the French DST does not apply to traditional advertising platforms such as radio, television, and print, among others, but rather is limited to digital advertising and the sale of personal data[244].

Tensions between the two governments seem to have eased sharply on the G7 held in France, in Biarritz, from 24 to 26 August 2019, where presidents Macron and Trump seem to have found a "compromise". Indeed, as reported by the well-known French newspaper "Le Monde"[245], France will undertake to refund to the companies concerned by the French web tax the difference between its tax and the future taxation currently under discussion at the international level. So if, when a single global web tax comes into force, it was to be less than 3% that digital companies are already paying in France, then they would receive a tax credit. Under the deal, France will abolish its 3% DST once a new international taxation agreement is reached, which the OECD expects to occur by 2020. France will reimburse companies that pay the DST once the international agreement is in place.

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[243] "*Web tax, perche Trump difende Google e Amazon"*, in "*Il sole 24 ore*", 11 July 2019

[244] Paul Miller, P. and Gardner, N., 2019. SPECIAL ISSUE – *Taxation of the Digital Economy*. *Global Tax InsIght*, (5), pp.12- 15.

[245] Piquard, A., 2019. « *Taxation Des GAFA: Au G7, La France Annonce Un « Bon Compromis » En Vue D'Une Solution Internationale*. [online] Le Monde.fr. Available at: <https://www.lemonde.fr/economie/article/2019/08/26/taxation-des-gafa-la-france-tente-de-nouer-un-compromis-avec-trump_5502968_3234.html> [Accessed 18 March 2020].

SECTION 2

1. Web Tax in Italy Background

The rapid expansion of the digital economy in all sectors of commerce requires diverging whether the traditional taxation systems are still suitable to effectively frame the taxation of new forms of business and products related to these. It is known that the globalization of the market has led companies to change their production structures in order to improve their competitive capacity and reduce the costs of management, including tax, taking into account the particular importance assumed by technological development and the diffusion of new types of intangible assets.

The broad debate generated at the international level on the taxation of the digital economy culminated, in Italy, in the elaboration by the national legislator of its own regulatory solutions in order to subject the income produced by companies operating in the field of the digital economy.

Italy has been one of the most active countries in the debate on the taxation of digital multinationals, engaging in the evaluation, as well as in the adoption, of various legislative proposals to optimise the income from these companies.

The complex process of debate and propositions originated in 2013. On October 4, 2013, a bill was sent to the Chamber of Deputies with as its first signatory the honorable Francesco Boccia (then chairman of the Budget Committee of the Chamber of Deputies), concerning Introduction of Article 12-*bis* of the Decree of the President of the Republic October 26, 1972, No. 633, on the application of value added tax for purchases of services electronically, and named Web Tax.

The proposed law provided for the obligation for customers of online services (national VAT taxable persons) to purchase goods or services electronically only from subjects in possession of an Italian VAT number, extending the obligation also to online advertising, with payments to be made to guarantee full traceability[246].

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[246] *It is clear that these advertising spaces can be viewed in the Italian territory during the visit of a site or the use of an online service, through landline or network and mobile devices. At present, the Italian*

The *ratio* behind the proposal was clearly to fight tax evasion in online shops (that is attributable to e-commerce), trying to close the regulatory gap that caused the difficulty in identifying territoriality in digital transactions[247].

The proposal, adopted unanimously by the Budget Committee in the Chamber of Deputies and published in the Official Journal on 27 December 2013, had been absorbed within the Stability Act of 2014 and was structured as a legislative amendment that would have added Article 17 *bis* in the Decree regulating VAT. The rule should have entered into force from 1 January 2014. However, the entry into force of this provision was postponed and was definitively repealed (without being applied) as the European Commission, following an investigation against Italy, highlighted the profiles of contrast with the fundamental freedoms and with VAT rules[248].

Following the latter proposal, the issue of digital taxation has been brought to the attention of the Italian Parliament through a document containing the proposal of Law No. 3076 initiative by Mr. Stefano Quintarelli and four other colleagues: "*Amendments to the single text of income taxes, referred to in the Decree of the President of the Republic of 22 December 1986, n. 917, and to the Decree of the President of the Republic of 29*

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advertising traffic is increasingly bought abroad by foreign operators, who in turn sell from abroad making absolutely untraceable the operation of buying and selling. [...]"It is clear that these advertising spaces can be viewed in the Italian territory during the visit of a site or the use of an online service, through landline or network and mobile devices. At present, the Italian advertising traffic is increasingly bought abroad by foreign operators, who in turn sell from abroad making absolutely untraceable the operation of buying and selling. [...]" Parliamentary acts Chamber of Deputies, Bill n.1662, Introduction of Article 12-bis of the Decree of the President of the Republic of 26 October 1972, n. 633, on the application of value added tax for purchases of services by telematics, 2013).

[247] The rationale is to combat tax evasion typical of online transactions, understood as direct or indirect electronic commerce, which, as is now known, escape the taxation regime of countries where, in fact, goods or services sold and on which, therefore, revenues are generated. In the sale of goods and services online, in fact, it is difficult to identify the «territoriality» of the seller and also, sometimes, the place of use or use of the good. In order to overcome this regulatory gap, therefore, the proposed law aims to impose, on legal entities with headquarters in foreign markets, but that profit from the Italian economic context [...]" (F. Boccia and others, proposed law n. 1662, 2013).

[248] Investigation of the European Commission initiated as the standard in infringed the principle of the free movement of goods and services, ending up excluding from the Italian market operators without of an Italian VAT number. In addition, the real useful effect of the initial web tax proposal could be excluded considering both the rules on taxation at the place of the principal, for the service part electronic, to enter into force on 1 January 2015, both the introduction of the MOSS collection system, aimed precisely at avoiding an excessive burden on the supplier, consisting in the need to open a VAT number in each State in which they are found the final customers.

September 1973, n. 600, for the contrast of tax avoidance in transactions carried out by telematics".

The present proposal differs from the previous one as it is more complex and proposes to act both on the direct and indirect tax side, by introducing measures with a clear anti-avoidance objective.

The proposal provides:

(i) a redefinition of the concept of a permanent establishment suitable to include (Art. 162 T.U.I.R) the online activities carried out by a non-resident company through:
  - one service provider on behalf of the enterprise;
  - one or more servers;
  - essential activities;
  - a virtual permanent establishment
  - or ongoing on-line activities (with a minimum duration of six months) which generate a total turnover exceeding the threshold of EUR 5 million imposed within the document; beyond which a reporting obligation for financial intermediaries would enter into force[249];

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[249] *On this point it is useful to cite the proposed legislative modification to the art. 1:" [...]3. This Article shall also apply to the virtual permanent establishment where: a) the location of an online service does not in itself constitute a permanent establishment; b) the location of a service provider that deals with the hospitality and management of the online service is not relevant for the identification of a permanent establishment, unless such services are rendered by an agent dependent on the enterprise, acting in its name and on its behalf; c) the physical location in the State of the servers related to the online service is not in itself sufficient to assume the existence of a stable organization; however, the provider of server-based internet access available to the enterprise may set up a permanent establishment to the extent that it can be qualified as an employee of the enterprise; d) a server can in any case be considered a stable organization if the activity carried out through it is significant and essential for the enterprise. 4. In any event, a permanent establishment in Italy shall be deemed to exist if there is a continuous presence of online activities attributable to the non-resident enterprise for a period of not less than six months, such as to generate in the same period flows of payments in its favour, in any case justified, not less than EUR 5 million in total. 5. In cases where the thresholds laid down in this Article are exceeded, it shall be for the financial intermediaries which have made the payments to report to the financial administration, in a manner to be defined by decree. [...]"* (Stefano Quintarelli and others, parliamentary acts Chamber of Deputies, proposal of law n. 3076, Amendments to the single text of the taxes on the incomes, of which to the decree of the President President of the Republic 29 September 1973, n. 600, for the fight against tax avoidance in transactions executed by telematics, 2015).

- the application of a 30% withholding tax on digital transactions by natural persons implemented by the financial intermediaries involved in the processing of the transaction[250];
- deterrents related to the elimination of double taxation concerning the income of categories of entities identified in the previous two points[251].

A further proposal, dates back to 14 September 2016 and was drafted by Senator Massimo Mucchetti (AS 2526, "Tax Measures for Competition in the Digital Economy").

The draft law of Mr Mucchetti is, in many respects similar to the proposal for a law sent to the Chamber of Deputies on the initiative of Mr Quintarelli.

After a general description of the main issues relating to digital taxation, both in Europe and in the USA, the document points out that: "[...] *although it considers that decisive and definitive intervention by the OECD on this subject would be preferable, while leaving VAT profiles to the EU Commission, which has exclusive competence, however, it is possible to better target the Italian Financial Administration's confirmatory action by providing it with more appropriate information tools that will enable it to arrange the most effective anti-circumvention* [...]"[252].

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[250] Art. 2: "*In Article 23 of the single text of income taxes, referred to in the Decree of the President of the Republic of 22 December 1986, No. 917, and subsequent amendments, the following amendments are made: a) in paragraph 1, finally, the following letter is added: a) income from on-line transactions relating to payments made by residents, at the time of the purchase of digital products or services from an e-commerce provider abroad, to be defined by decree of the Minister of Economy and Finance »; b) in paragraph 2, c) is replaced by the following: «c) the fees for the use of works of intelligence, industrial patents and trademarks, as well as processes, formulae and information relating to experience acquired in the industrial field, commercial or scientific fees and fees paid by domestic operators for the purchase of software licenses subsequently distributed on the Italian market ». 2. The fourth paragraph of Article 25 of the Decree of the President of the Republic No. 600 of 29 September 1973, as amended, is replaced by the following: the remuneration referred to in article 23, paragraph 1, letter g-bis) and paragraph 2, letter c) of the single text of income taxes, referred to in the decree of the President of the Republic 22 December 1986, n. 917, and subsequent amendments, paid to non-residents shall be subject to a 30 % withholding tax on the taxable part of their amount. Income from online activities referred to in Article 23, paragraph 1, letter g-bis), of the single text referred to in the Decree of the President of the Republic No. 917 of 1986, shall be subject to withholding by resident financial intermediaries, where they are involved in the collection of the relevant cash flows and income. Withdrawal shall be made at the time when the intermediaries intervene in the collection of the aforementioned income* [...]" (S. Quintarelli and others, proposed law n. 3076, 2015).

[251] Quintarelli S. and others, proposal of law n. 3076, 2015, article 4.

[252] Massimo Mucchetti, Parliamentary Acts Senate of the Republic, Bill No. 2526, Tax measures for competition in the digital economy, p. 4, 2016.

Unlike the proposal No. 3076, the drawing is not proposed, to implement a redefinition of the concept of permanent establishment, specifying that the burden of implementing such a measure must be entrusted to the international organizations[253].

Instead, the document identifies a series of mechanisms to restore fair competition between companies in the sector by reviewing some aspects of the digital taxation; in particular:

- obligation of disclosure by the financial intermediaries involved in the process of payment to the Revenue Agency after exceeding certain thresholds instead of direct action by the Agency[254];
- configuration of a permanent establishment ("hidden") exceeding certain thresholds for digital activities carried out in Italy over a period of 6 months (number of transactions carried out in excess of 500 units, total turnover relating to these transactions not less than 1 million euros)[255];
- application of remedies for distortion of competition (otherwise subject to contradictions), including: obligation on financial intermediaries to suspend payments to persons who do not have a VAT number of transactions[256]; application of a 30% withholding tax (taxable part of their amount) on: "*fees for the use of works of ingenuity, industrial patents and trademarks and of processes,*

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[253] "*[...] It is therefore not proposed, at least here, to rewrite the provisions for identifying a permanent establishment. This work certainly deserves to be accelerated in every way, given the age of the regulatory categories in force and also the concepts expressed in the OECD commentaries on the subject. And yet it can only be entrusted to the international organizations [...]*" (M. Mucchetti, DDL no. 2526, 2016).

[254] art. 1*: "1. Financial intermediaries making payments on behalf of their clients to the foreign country shall also take the VAT registration number and the authority which issued it as one of the beneficiary's identification data. Where the beneficiary does not have a VAT registration number and the transactions effected through the same financial intermediary exceed, during a half year, the two hundred units, the person in charge of the payment must inform without delay the Revenue Agency with the modalities established by the directorial provision issued by the latter [...]"* (M. Mucchetti, DDL no. 2526, 2016).

[255] Mucchetti M., DDL no. 2526, 2016, Article 2.

[256]Article 1 paragraph 2: "*The information referred to in paragraph 1 shall be communicated to the beneficiary and shall be accompanied by an invitation to obtain a VAT number from the competent authority, if the trader belongs to a Member State of the European Union; or the Revenue Agency if not. The financial intermediary concerned may not proceed with further payments until the VAT number has been communicated".* (M. Mucchetti, DDL n. 2526, 2016).

formulae and information relating to experience acquired in the industrial, commercial or scientific field[257]*",*

- in addition to: "*the fees paid by domestic operators for the purchase of software licences distributed on the Italian market*", paid to non-residents[258]; application of a withholding tax (26% of the amount to be paid) on payments made to non-residents, until the creation of a permanent establishment in Italy[259].

The proposals described were, however, partial and unilateral and, if adopted, they could not be applied in practice as they differ from the forecasts of international agreements against double taxation, in particular concerning the definition of a permanent establishment and the income to which it is possible to apply withholding taxes. The conventions, likely, would eventually prevail over the internal provisions on the same based on the principle of specialty. Besides, the digital multinationals could easily invoke the above principle to overcome any disputes related to their virtual presence in our country[260].

A further problem, common to both proposals, would instead be the non- viability of the involvement of financial intermediaries. The concrete exercise of the obligation to apply a withholding tax would, in fact, place a considerable procedural burden on intermediaries, making them directly liable to the financial administration for the sums collected under the levy[261] and, as a result, making a process considerably more cumbersome, that is, the processing of payments.

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[257] T.U.I.R, Art.23 comma 2 lett. c.

[258] art. 4 of DDL: "*1. Article 25 of the Decree of the President of the Republic of 29 September 1973, n. 600, the fourth paragraph is replaced by the following: 'The remuneration referred to in Article 23, paragraph 2, letter c), of the single text from income taxes, referred to in the Decree of the President of the Republic of 22 December 1986, No. 917, paid to non-residents, are subject to a withholding tax of thirty percent as tax on the taxable part of their amount»".* (M. Mucchetti, DDL no. 2526, 2016).

[259] art. 5: "*1. Article 25-bis of the Decree of the President of the Republic No. 600 of 29 September 1973, after the eighth paragraph the following is added: 'The persons responsible for making payments to non-residents referred to in Article 41.1, paragraph 2, shall be subject to a withholding tax of 26 per cent on the amount to be paid. The withholding tax does not apply to non-residents who have a permanent establishment in the territory of the State. For payment periods and declaration procedures, the provisions of the seventh paragraph of this Article shall apply".* (M. Mucchetti, DDL no. 2526, 2016).

[260] Sepio G. - D'Orsogna M., "*Impresa multinazionale digitale e tassazione delle transazioni on line*", in *il fisco,* 29/2015, p. 285.

[261] Gallo F., "*Prospettive di tassazione dell'economia digitale*," in *Diritto Mercato Tecnologia*, 1/2016 p.

In this context, the new Art. 1-*bis* of D.L. April 24 2017 No. 50 should be placed,which introduced the so-called "*transitional web tax",* which consists of an optional contradictory on the existence of a permanent establishment in Italy, also for past tax periods, with the forecast of special benefits. The Italian legislator thus confirms that it has oriented towards a more targeted approach to tax compliance, thanks to a collaborative reward scheme to incentivise multinationals (digital and not) to dialogue with the Financial Administration and make identify any tax bases related to the existence or otherwise of a permanent establishment.

This is not, therefore, a new form of levy or new presumptions, but of an investigation procedure (and where appropriate, findings) addressed to all undertakings of major importance size, irrespective of the relevant economic sectors of interest (it is therefore not a regime intended for digital multinationals, different with previous legislative proposals).

In practice, the adversarial procedure is initiated at the request of the taxpayer and shall be carried out following the rules laid down for the scheme of *cooperative compliance*, provided that the party has not already had formal knowledge of access, inspections and verifications or the start of any administrative control activity or, again, of the start of criminal proceedings concerning matters which may be dealt with in this process.

If this has not happened, the Agency proceeds to the investigation in adversarial and, if it finds the subsistence of a permanent establishment and the relative incomes, it emanates the invitation for the verification with adhesion which, according to Art. 5 paragraph 1 of D.Lgs. n. 218/1997, will have to indicate the periods of tax inclined to ascertain the day and the place of the appearance, the higher taxes, sanctions, and interests that are considered due.

The procedure is based on the spontaneous and agreed emergence of permanent establishment on the basis of certain criteria:

- consolidated group turnover of more than EUR 1 billion;

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- supply of goods and services in Italy for a total value of more than EUR 50 million, including through resident enterprises belonging to the group.

The legislation postulates that, exceeded these thresholds, it is possible to approach the regime of collaborative fulfilment according to the legislative Decree No. 128/2015[262], making sure that the Revenue Agency, after a first phase of an in-depth examination with the company, assess the actual existence of the permanent establishment or not. If the evaluation is successful, the non-resident enterprise will receive an invitation to the tax assessment with adhesion.

The reward of the web tax is that the company, paying the sums identified in contradictory, gets a significant discount on administrative penalties and ensures the non-punishable for the crime of failure to declare. Furthermore, it is also provided for the access to the cooperative compliance procedure regardless of the amount of turnover or revenues of the building organisation, without prejudice to the need to integrate the other conditions necessary for collaborative fulfilment, first and foremost the existence of the so called tax control framework[263].

However, the present standard has not introduced a special form of levy or a new charge, nor is it only available to digital enterprises.

The discipline is nothing more than a form of voluntary collaboration aimed at promoting and facilitating a comparison between foreign multinationals and Italian financial administration and aimed at clarifying whether there is a permanent establishment in the territory of the State foreign companies in the group[264].

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[262] "art. 3, 1. *In order to promote the adoption of enhanced forms of communication and cooperation based on mutual trust between financial administration and taxpayers, as well as promoting the prevention and resolution of tax disputes in the common interest, the collaborative settlement scheme between the Revenue Agency and taxpayers with a collection system is established, the measurement, management and control of tax risk as a risk of operating in breach of tax rules or contrary to the principles or objectives of the tax system. [...] art. 6, 1. Membership of the scheme means that taxpayers have the possibility to reach a common assessment with the Revenue Agency of situations which may give rise to tax risks prior to the submission of tax returns, through forms of constant and preventive interlocution on factual elements, including the possibility of anticipation of control. [...]"* (legislative Decree 128/2015).

[263] Sepio G., D'Osogna M., "*La web tax transitoria per le multinazionali digitali (e non solo)*", in "*Il Fisco*", n. 31 del 2017, p. 1-3020.

[264] Cerrato M., "*La procedura di cooperazione e collaborazione rafforzata in materia di stabile organizzazione* (c.d. *web tax* transitoria)", in *Rivista diritto tributario*, Fascicolo 6/17, 2017, pp. 751 ss.

After examining the new legislation, the Parliamentary Budget Office made critical assessments of some aspects of the new procedure. In particular, the Office considered that:

- in spite of the designation conferred (Transitional Web Tax), the provision does not aim to create an ad hoc taxation on digital companies and, on the contrary, appears a more general anti-profit and anti-abuse manoeuvre directed at multinationals;
- contrary to the provisions of the DDL Mucchetti, it was here preferred to argue on the incentive to the voluntary tax compliance in the matter of permanent establishment through rewards effects, rather than the penalty resulting from the non-regulation of the condition itself;
- since digital enterprises are those one that can most easily evade taxation through the permanent establishment, they remain the implicit objective of the new standard. Nevertheless, the advantage of joining the new procedure is much greater for companies at risk of ordinary assessment than for digital companies, which could, on the contrary, be encouraged to exploit the elusive margins available to them and to defer the negotiation of tax charges[265].

2. Budget Law 2018

Following the rapid expansion of the digital economy and in the light of aggressive tax planning strategies put in place by companies operating in the sector, to give a response to the challenges posed by the digital economy, with the Budget Law 2018 the Italian legislator introduced a package of rules (Article 1, paragraphs 1010–1019) specifically addressed to the digital economy.

The structure of the new tax is the result of a particularly tortuous legislative process, during which the initially planned regulation has undergone substantial changes.

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[265] Ufficio Parlamentare di Bilancio, Flash n. 5 / 1° August 2017.

The Budget Law 2018 (Law No. 205/2017), published in the Official Gazette on 29 December 2017, provided in particular:

(i) significant changes to the rules of the permanent establishment, contained in Article 162 TUIR, and to the criteria for its determination, in order to align the internal legislation to the innovations introduced in the BEPS project;

(ii) the introduction into Italian law of a tax on digital transactions relating to the supply of services by electronic means to residents or permanent establishments of non-residents located in the territory of the State.

Paragraph 1010 of Article 1 of the Budget Law 2018 revised the definition of a permanent establishment in Article 162 TUIR, making important changes that take into account the results achieved by Action 7 of the BEPS Project, adapting the Italian legislation to the new Article 5 of the OECD Convention.

The reform measure amends Article 162 in four respects:

- widens the so-called *positive list* with the insertion in paragraph 2 of the letter f)-*bis*, according to which within the hypotheses that constitute a material permanent establishment falls also a "*significant and continuous economic presence in the territory of the State, built in such a way that it does not show a physical consistency in the territory of the same*" and repeals at the same time paragraph 5 which established that the availability of "*computers and their ancillary equipment enabling the collection and transmission of data and information for the sale of good and services*" do not constitute a permanent establishment;
- completely rewrites the so-called *negative list* contained in paragraph 4 of Article 5 OECD Model Convention;
- introduces in the new paragraph 5 of Article 162 the so-called *anti-fragmentation* rule, aimed at avoiding that the activity is fractionated between several connected enterprises in order not to incur one of the hypotheses that, considering the activity in a unitary way, they would configure a permanent establishment;
- changes the concept of a personal permanent establishment by ascertaining that the staff member who usually concludes contracts on behalf of the enterprise is a

permanent personal establishment, but also the agent who leads to the conclusion of contracts without substantial changes by the undertaking[266].

First of all, the Budget Law integrated paragraph 2 of Article 162 TUIR with the new letter f-*bis*), aimed at specifying that it constitutes a permanent establishment in Italy also "*a significant and continuous economic presence in the territory of the state built in such a way as not to result in its physical consistency in the territory of the same*".

This intervention complements the so called *positive list,* that is to say the list of cases constituting a material permanent establishment, and setting up a new one which originates in the indications provided at OECD level, in particular by action 1 of the BEPS Project and that concerns the need to overcome the approach for which the qualification of a permanent establishment would be considered to be linked to the settlement of a physical structure in the territory of the State[267].

As pointed out in the parliamentary documentation of the works on the Budget Law 2018, the rewriting of the criteria to determine the existence of a permanent establishment has the purpose "*to alleviate the hitherto unavoidable link between the physical presence of an activity in the territory of the State and subject to fiscal legislation, while emphasising the reference to the elements of stability, the recurrence and the economic dimension of the activity with the intention of preventing, by the taxpayer, manipulations which prevent the qualification of a permanent establishment*"[268].

The introduction of the letter f-*bis*) to paragraph 2 aligned the national legislation with the directives given under Action 1 of the BEPS in particular with regards to the point where it describes the need to ascertain a new nexus identified in the significant economic presence appropriate tax base in the digital economy.

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[266] Benigni C., "*Modifiche alla definizione di stabile organizzazione",* in *Pratica Fiscale e Professionale*, 3/2018, p. 82.

[267] Corso L. Odetto G., "*Le novità della legge di bilancio 2018 e del DL collegato",* in *Quaderni Eutekne*, 2017.

[268] Servizio Studi del Senato, *Legge di Bilancio 2018 (I Sezione) – Gli emendamenti approvati dalla 5^a^ Commissione,* Dossier 560/2, A.S. n. 2960.

This has made possible to include in the notion also those situations in which the enterprise participates in the economic life of the State in a regular and continuous way without having a physical presence and overcome the concept of permanent establishment based on traditional territorial roots, instead emphasizing the place where the activities and the wealth is produced[269].

However, Assonime is against this approach. In fact in circular No. 15/2018, it formulated the thesis according to which the provision referred to in letter f-*bis*) of Article 162 cannot qualify as a new hypothesis of a permanent establishment which joins those already provided for in the *positive list*, as any indications regarding the parameters to be used to determine if and when a significant economic presence can be said to exist. According to Assonime, the provision has anti-avoidance value and is therefore aimed at allowing the Financial Administration to counteract behavior aimed at hiding the physical presence of the foreign company in Italy. The standard serves to qualify situations where there is an actual physical presence as permanent establishment, which however is disguised for the particular business model adopted by the company[270].

The *negative list* is also of fundamental importance. The latter was amended by the 2018 budget with the introduction of paragraph 4 in Article 162, providing for a stricter delimitation of the cases of exemption from the concept of permanent establishment.

The *negative list* of paragraph 4 contains a series of cases in which, although there is a fixed place of business, there is no permanent establishment because that place is used for the exercise of activities that are not strictly related to the production of income. The common feature of these cases is the preparatory or ancillary nature of the activity. A nature that must be established on the basis of qualitative and quantitative parameters and having regard to the essentiality and significance of the activity carried out, compared to that of the enterprise considered as a whole.

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[269] Ferroni B., "*Stabile organizzazione: la disciplina nazionale si adegua al BEPS e introduce la "continuativa presenza economica",* in *Il Fisco*, 7/2018, pp. 1 – 632.

[270] Della Valle E., "*La stabile organizzazione "da remoto": la lett. f-bis) dell'art 162 del TUIR e l'approccio OCSE,* in *Rassegna Tributaria*, 3/2019, pp. 470 – 483.

Paragraph 4 of Article 162 mentions among the cases of preparatory or auxiliary activities those in which the fixed place of business is used "*for the sole purpose of storage, display or delivery of goods belonging to the enterprise*" or when the undertaking's goods or commodities are "*stored solely for storage, display or delivery purposes*". Another case of a fixed place of business which does not qualify as a permanent establishment is where the establishment is used "*for the sole purpose of acquiring assets or collecting information for the enterprise*".

Following the work carried out by the OECD in the framework of the BEPS project, Law No. 205/2017 made amendments to paragraph 4, specifying in paragraph 4 *bis* that all the activities listed in the negative list must be of a preparatory or auxiliary nature.

Therefore, it should be noted that the traceability of the activity carried out by the enterprise among those listed in paragraph 4 does not allow ex se to qualify the activity itself as preparatory or auxiliary[271].
This means that all the activities listed in paragraph 4, in order to be considered irrelevant for the integration of the existence of a permanent establishment, must in themselves have the preparatory or auxiliary character[272].

The change was mainly made with reference to digital economy enterprises. These companies, operating through the internet and using only a warehouse as a form of physical presence, are able to operate in different countries without the relative fixed business location (the warehouse) being qualified as a permanent establishment precisely because of the provisions of paragraph 4. For these companies, in fact, the storage of goods goes beyond the preparatory or auxiliary function and constitutes an essential phase of the economic cycle of the business activity.

To complete the amendments made to the preparatory or ancillary activities, the Budget Law introduced, in accordance with the new paragraph 4.1 of Art. 5 of the OECD Model, in the new paragraph 5 of Art. 162 TUIR the *anti-fragmentation* rule, designed to

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[271] Salvini L., *Diritto tributario delle attività economiche*, Giappichelli, 2019, Torino, p. 220.

[272] Trainotti A. Piazza M., "*Le ipotesi negative nella nuova definizione di stabile organizzazione",* in *Fiscalità & Commercio Internazionale*, 5/2018, pp. 5 – 10.

prevent a non-resident undertaking from artificially splitting individual phases of a unitary activity, within the enterprise or between several related parties, to bring each of those steps into the exemptions from a permanent establishment.

The rule therefore provides that the exemption from the permanent establishment regime to the activities referred to in paragraph 4 is not recognized in two cases:

1) there are several complementary activities that the same undertaking carries out in different locations in the country where at least one of those activities matches the requirements of the permanent establishment or where the combination of complementary activities cannot be considered as preparatory or auxiliary;
2) there are several complementary activities that several closely related enterprises carry out in the country where at least one related enterprise carries out an activity that constitutes a permanent establishment or where the combination of complementary activities carried out by the different enterprises strictly related is not merely auxiliary or preparatory[273].

Finally, the Budget Law 2018 amended the definition of a permanent personal establishment, taking into account the relevant provisions of Action 7 of the BEPS Project.

In particular, by amending paragraph 6 of Article 162 TUIR, the concept of an independent agent has been extended to cover the case where an entity acting in the territory of the State on behalf of a non-resident undertaking, normally operates for the purpose of concluding contracts without any substantial change on the part of the undertaking itself. Therefore, not only the person who usually concludes contracts, but also the person who works for the conclusion of contracts on behalf of the non-resident undertaking, is included in the definition of a permanent personal establishment which shall sign them without making any substantial changes. It is also made clear that the permanent personal establishment is integrated if such contracts are concluded in the name of the non-resident undertaking or if they concern the transfer of ownership or the

[273] Gaiani L., *La "nuova" stabile organizzazione sotto la lente di Assonime",* in *Il Fisco*, 29/2018, pp. 2863 ss.

granting of the right to use company assets or are related to the provision of services by the company.

Upon recourse to such circumstances, the permanent establishment shall be excluded only if the staff member carries out exclusively preparatory or ancillary activities[274].

These changes are associated with the rewording of the independence requirement, the use of which is no longer the case for a personal permanent establishment.

The independence of the agent in relation to the undertaking must occur both legally and economically. As regards the first aspect, it is necessary to consider the scope of the obligations which the agent assumes towards the undertaking: if the activity which the agent carries out on behalf of the undertaking is subject to detailed instructions and general control, that person cannot be considered independent of the undertaking.

Another relevant criterion is that of bearing the entrepreneurial risk: only if the risk falls on the agent, the latter can be considered independent from the enterprise. Law No. 205/2017 also amended paragraphs 7 and 7 *bis* of Article 162. This is the case where an entity operates exclusively (or almost) on behalf of one or more enterprises to which it is closely related, meaning the case where there is a direct or indirect control relationship between the agent and the non-resident enterprise. In this case, the entity cannot be considered as an independent agent.

The amendment consists in the clarification that a staff member cannot be regarded as an independent agent and therefore does not qualify as a personal PE if he is working exclusively or almost exclusively on behalf of one or more undertakings to which he is closely related[275].

These provisions were mainly aimed at counteracting the behaviour of large digital multinationals which, where they consider it convenient or appropriate to operate

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[274] Sella P., "*Le modifiche della Legge di bilancio 2018 alla definizione di stabile organizzazione personale",* in *Fiscalità & Commercio Internazionale*, 5/2018.

[275] Loconte S., "*Stabile organizzazione: l'Italia si adegua al nuovo Modello OCSE",* www.ipsoa.it, 22 January 2018.

in countries other than their country of residence without a permanent establishment, ensure that their presence does not integrate all the requirements of the permanent establishment[276].

2.1 “Web tax”

One of the most important innovations of the Budget Law 2018 (Art. 1, paragraphs 1011 - 1019) was the introduction, with effect from 2019, of a specific tax for the taxation of the digital economy, the so called *Web Tax*.

The essential characteristics of the tax in question, established by Art. 1, paragraphs 1011 ss. of Law No. 205/2017 follow up the outcome of the informal Ecofin Summit held in Tallinn on 15 and 16 September 2017 and the above-mentioned Commission Communication of 21 September of the same year (COM (2017) 547 (final).

This is reflected in a tax on digital transactions relating to the supply of services through electronic means made vis-à-vis substitute resident entities and permanent establishments of non-resident entities located in the territory of the State. The tax is applied to the value of the individual transaction, net of VAT, with a rate of 3%.

The assumption for the application of the charge is identified only in the transactions that correspond to the provision of a service through electronic means of type B2B.

Paragraph 1012 of Article 1 specifies that “*Services provided by electronic means shall be those provided via internet or an electronic network, the nature of which makes the provision essentially automated, accompanied by minimal and impossible human intervention in the absence of information technology*”.

In any case, the concrete identification of the services affected by the tax has been entrusted to a Decree of the Ministry of Economy and Finance which is linked to the entry into force of the tax itself.

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[276] See the reference to *commissionaire arrangements* as a method to evade the tax system. Chapter 1 par. 3.2 letter A, Permanent establishment.

The *Web Tax* does not apply therefore neither to the activities of e-commerce neither to the cessions of assets, but it remains limited to the single services characterized from the Ministerial Decree[277].

The taxable entities are all those enterprises, whether resident or not, who lend electronic services to residents who qualify as tax substitute within the meaning of Article 23 of D.P.R. No. 600/1973[278] (except for the area of agricultural entities to Law No. 190/2014 and of those who start new initiatives ex lege No. 111/2011) and in favour of permanent establishments of non-residents.

Digital transactions vis-a-vis private parties (B2C transactions) are therefore excluded from the scope of the web tax, since private individuals do not constitute tax substitutes under Article 23 of D.P.R. No. 600/1973[279].

Concerning these exemptions, some believe[280] that, among the subjects referred to in Art. 23 paragraph 1 D.P.R. n. 600/1973, to which the norm makes reference, those of small dimensions could be burdened by the levy indirectly. Examples include the use of analysis, transmission and data processing services, advertising on social media or online search engines, or the promotion of services through the use of online platforms acting as intermediaries.

There is also an express exclusion from the application of the web tax for services provided to persons who have joined the flat-rate scheme for minimum taxpayers[281], of the subjects who have adhered to the fiscal advantages for the juvenile entrepreneurship and the workers in mobility[282].

The identification of such a large pool of operators seems consistent with the will to hit phenomena of tax evasion that arise in the head of the suppliers of digital services,

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[277] Della Valle E., *La web tax italiana e la proposta di Direttiva sull'Imposta sui servizi digitali: morte di un nascituro appena concepito?* in *Il Fisco*, 16/2018, p. 1 – 1507.

[278] On the role of tax substitute of non-resident entities with permanent establishment on the territory of the State see C.M. 23 December 1997, n. 326/E.

[279] Miscali M., "*Web tax all'italiana: è la scelta giusta?*" www.ipsoa.it, 27 January 2018.

[280] Tomassini A., "*L'incerta corsa alla tassazione dell'economia digitale*", in *Corriere Tributario*, 3/2018.

[281] Introduced by Art. 1, paragraphs 54-89 of the Law of 23 December 2014, No. 190, (Stability Law 2015).

[282] Provided by Art. 27 of the Legislative Decree 6 July 2011, No. 98 converted by Law 15 July 2011, No. 111.

not necessarily conditioned by the economic potential of individual clients (who could make up with the number of the economic entity of the individual benefit). Nevertheless, the legislation expressly excludes from taxable transactions those made against specific entities advantage schemes granted on the basis of their small economic importance.

This exception seems at first sight to operate in a single direction, when they are made to such subjects, and not vice versa[283].

On the provider's side, however, it is expected that the web tax will apply to the provider of the service by electronic means, provided that during a calendar year it carries out a total number of digital transactions of more than 3,000 units, without taking into account the amount of individual transactions: the tax assumption could be defined, for example, either by 3,000 transactions with a value of 1 euro each, or by 3000 transactions with a value of 1000 euro each[284].

The legislation is therefore also applicable to people resident in Italy, regardless of the Legal form adopted, provided that they put in place digital transactions above the threshold of 3,000 units provided by the legislator.

The territoriality of the tax would therefore be identified according to the customer of the service and not of the provider of the same, regardless of the place of conclusion of the transaction[285] (according to Article 1 paragraph 1013, Law No. 205/2017).

From this particular point of view, it is worth noting that the Parliamentary Budgetary Office (press release of 29 December 2017) has raised certain criticisms precisely in relation to resident companies which, under these circumstances, will have to pay this new tax - to some extent comparable to VAT- in addition to ordinary direct taxation, without the grant of any tax credit, as originally planned.

Paradoxically, in our legal system this would create a situation diametrically opposite to that occurred in the British and Indian legal system where, following the

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[283] Confindustria, Nota di aggiornamento 10 gennaio 2018, "*Legge di bilancio 2018 - Misure fiscali d'interesse per le imprese - Prime osservazioni aggiornate alla pubblicazione del testo definitivo*", p. 103.

[284] Ufficio Parlamentare di Bilancio, *La nuova imposta sulle transazioni digitali,* Flash n.9/29 december 2017

[285] Avolio D., Pezzella D., "*La web tax italiana e la tassazione dei servizi digitali",* in *Il Fisco*, 6/2018, p. 1 – 525.

introduction of the related web tax, it was argued the illegitimate introduction of an advantage in favour of resident enterprises. In particular, the Parliamentary Office pointed out that web tax was likely to lead to a competitive disadvantage for resident companies in relation to both the traditional internal market and the international market.

In fact, the revenues of resident digital companies are subject not only to the new tax, but also to other direct taxes with the rates in force in Italy and a higher effective tax burden. On the contrary, for non-resident multinationals the new tax could definitively meet the tax obligations in Italy by continuing to pay derisory tax rates in states with favourable tax regimes.

Furthermore, the large non-resident multinationals, having a much greater market power of Italian companies, could operate more easily a translation of the tax on the prices of the services, without reducing their competitiveness.

On the other hand, however, the relatively high tax rate seems to constitute a compromise between the the need to fight tax avoidance and the intention not to penalize too much resident enterprises.

The established proportional rate is unique, in the amount of 3% of the consideration due, net of VAT, for each service. The tax is therefore characterized by the forecast of a relatively low rate, but which is applied to a broad tax base consisting of the proceeds of the sale of the services assumed on the assumption of the levy[286].

The tax, although of real nature, shall apply only to the lending entity resident or not[287], which makes during a calendar year a total of transactions exceeding 3,000 units: the taxable person will then be taxed on the basis of the volume of transactions carried out, without taking into consideration the amount of the income received.

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[286] Gabelli M., "*La nuova imposta sulle transazioni digitali",* in *Fiscalità & Commercio Internazionale*, 3/2018.

[287] The identification of the connecting criterion represented by the territorial assumption of the fiscal power lies in the need not to assume at the assumption of taxes events without reasonable connection with the territory of the State and therefore to specify a "reasonable link between the ability to contribute manifested by the assumption and the legal system to which the rule governing the charge belongs, thus delimiting the scope of the national tax": in this sense, see. G. Marino, *The control report in tax law. Interdisciplinary analysis and systematic reconstruction,* Padua, 2008, 313.

To calculate "units", "transaction" shall be deemed to mean a single and autonomous "provision of services", capable of satisfying in a way accomplished a user interest; it should thus be taken into account the subject-matter of the contractual obligation, namely the individual performance deducted from the contract.

It can therefore be assumed that, at least for calculation of the three thousand "transactions", the payment of a fee of subscription to one or more services, for continuous use, periodically and repeatedly, should not be considered as the only administration or supply and then "transaction", but as many "units" as are the single, separable and autonomous utilities from the user in the use of the service[288].

Like the services affected by the tax, a decree of the MEF has been entrusted with the identification of the modalities of application of the *Web Tax*, including the declaratory and payment obligations.

Paragraph 1012 defines the "services provided by means of electronic" meaning those supplied via the internet or an electronic network, which, by their very nature, are automated[289].

The type of transactions involved is similar, but does not overlap with that found in the term "digital services provided through digital interface", used in the Directive on the taxation of companies with a significant digital presence.

The main difference between the two regulatory proposals lies in the value of the reference to electronic or digital services: in the Directive proposal, it is functional to integrate the hypotheses of permanent establishment, to which apply the corporation tax; in the Italian web tax the purpose of the proposal is to define the objective scope of the new levy. It can reasonably be assumed that the services to be identified by the Ministerial Decree have content similar to those typed in the other Directive proposal, regarding the introduction of the DST.

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[288] Spinapolice W, Uricchio A., "*La corsa ad ostacoli della web taxation*", in *Rassegna Tributaria*, 3/2018, p. 451.

[289] Automation is compatible with "minimal human intervention" and requires the need for information technology in order to be able to carry out the provision; it relates to "ontologically" digital services, in content, delivery and use.

As regard to the methods of collection, the withdrawal consists of a sort of withholding tax, payable by the customer at the time of payment, with an obligation of recourse on the service provider.

The tax is levied, upon payment of the fee, by the customers of the services with the obligation of recourse on the lenders; the same clients are then called to pay the tax on the 16th day of the month following the payment of the fee.

For the purposes of verification, penalties, collection and litigation, the provisions on VAT shall apply in so far as they are consistent[290].

The tax is built according to the model of indirect taxation, with similarities in relation to VAT and even more so the repealed "IGE"[291]: the tax mechanism structured in such a way as to affect a manifestation of fiscal capacity consisting not in consumption, but in the sale or, *rectius,* in the provision of a service with "electronic" or "digital" content to another economic operator, excluding business to consumer services[292]. A prerequisite for taxation is the conclusion of "digital transactions relating to the supply of services by electronic means" and not the creation or transfer of rights *in rem* and rights to tangible or intangible assets. Doubts arise, however, as to whether the prohibition on the introduction of taxes on the provision of turnover[293], affecting the same tax assumption and sharing the features[294].

The Court of Justice of the European Union (CJEU) has had to face the issue of the compatibility between the euro-unitary discipline of value added tax (VAT), as

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[290] Art. 1, comma 1016, of Law No. 205/2017.

[291] It was a multi-phase tax on full value and was imposed on the transfer of goods in all their value, and not only on the added value. It has been replaced by value added tax (VAT), in application of Directive 67/227/EEC, which describes it in its basic principles, for the harmonisation of the tax laws of the Member States of the European Economic Community.

[292] Spinapolice W., Uricchio A., "*La corsa ad ostacoli della web taxation"*, in *Rassegna Tributaria*, 3/2018, pp. 452 ss.

[293] This is intended to protect the rules of neutrality of taxation on the trade and the ban on distorting free competition in the European market, justifying the harmonization of indirect taxes (Article 113 TFEU).

[294] Article 401 Directive 2006/112/CE "*Without prejudice to the others Community provisions, the provisions of this Directive shall not prohibit a Member State to maintain or introduce taxes on the contracts of insurance, gaming and betting taxes, excise duties, taxes of register and any tax, duty or fee that does not have the character of turnover tax, provided that such a tax, duty or fee does not give rise to place, in trade between Member States, of formalities connected with the transit of a frontier*".

outlined by the Directive No. 2006/112/EU (VAT Directive) and the hybrid and potentially damaging figures of the organic system of the aforementioned indirect tax, the so-called “sales taxes”, sometimes introduced in the national systems.

This issue mainly concerns the compatibility of indirect taxes adopted in the national context with Article 401 of the VAT Directive. This rule allows Member States to maintain or introduce taxes, duties and charges on the supply of goods, services or imports at domestic level only if they are not characterised as turnover taxes.

In order to identify the nature of a turnover tax, it is necessary to examine whether the tax in question has a detrimental effect on the operation of the common VAT system by impacting on the movement of goods and services, as well as on commercial transactions in a similar way to VAT.

The judgment of 3 October 2006 in Case C-475/03[295], by which the Commission Court of Justice ruled out the incompatibility of IRAP with the system harmonised turnover tax[296], is significant.

The Court of Justice ruled out the incompatibility of IRAP with the system harmonised turnover tax.

In this case, the Court of Justice focused its analysis on the question of the possible overlapping of the regional tax with VAT, concluding that the two taxes were fully compatible and excluding any conflict between IRAP and the VAT Directive. The Court observed that while VAT is levied at each stage of marketing and its amount is proportional to the price of the goods or services supplied, IRAP is a tax calculated on the net value of the undertaking’s production.

The case law of the Court of Justice EU has summarised the essential characteristics of VAT into at least four points[297]: first of all, VAT applies in a general way to transactions with goods or services; it is a tax proportional to the price received by the taxable person in exchange for goods and services; it is collected in each of the

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[295] CJCE, 3 october 2006, Banco Popolare di Cremona Soc. Coop. Arl, C-475/03.

[296] Lupi R., Stevanato D., “*Il valore aggiunto tra IVA e IRAP: le due facce di un equivoco*”, in *Riv. dir. fin.*, 2/2005, pp. 249 ss.

[297] C-475/03, Banca Popolare di Cremona, 3 ottobre 2006; C-283/06 e C-312/06, *KÖGAZ et a.*, 11 october2007.

following ways production and distribution stage of the production and distribution process, up to the sale to the minute, regardless of the number of transactions carried out; the amounts paid at previous stages of the production and distribution process shall be deducted from the VAT payable by the taxable person, so as to apply, in each phase, only on the added value of the phase itself, until it affects ultimately on the final consumer.

Following the Community guidelines, the compatibility of the web tax with the harmonised rules on turnover tax could be accepted, since it is limited to transactions involving the supply of services by electronic means.

The CJEU has, however, excluded the similarity with VAT of consumption taxes without the character of the generality, aimed at specific sectors of economic activity[298].

The Court of Justice has noted that the tax on digital services which applies does not constitute a general tax only to leases of capital goods, as it concerns only a restricted category of operations and, therefore, is not intended for the burden on all economic operations in the Member State concerned.

The *web tax* lacks the core of the mechanism for the operation of VAT, based on recovery and deduction, and the application of the tax to the last step in the supply chain, that of the intended for the final consumer[299]. However, it is necessary to stress the possible criticisms, not only from the potential restriction of fundamental freedoms in the European common market, but from constitutional legitimacy, which can be raised regarding the duplication of taxation on the same assumption[300], shared by the digital transaction tax and value added tax. In both forms of taxation, the tax is levied as part of a production and distribution process and at every stage of it, with the fundamental

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[298] CGUE 14 october 1999, causa C-439/97, Sandoz Gmbh c/Finanzlandesdirektion für Wien, Niederösterreich und Burgenland.

[299] Gallo F., *Profili di una teoria dell'imposta sul valore aggiunto*, Roma, 1974, pag. 19; Comelli A., "*La natura dell'imposta*", in other authors., "*L'Imposta sul valore aggiunto"*, in *Giur. sist. dir. trib.*, a cura di F. Tesauro, Torino, 2001, p. 15 ss.

[300] In particular for infringement of Articles 3, 41, 42, 53 of the Constitution. In the present case, it is a question of domestic double taxation in respect of undertakings resident in Italy which are suppliers of principal undertakings still resident in Italy. That is because duplication does not affect the conflict between the source State and the residence State, but insists within the same national legal system.

differences of the non-applicability of the web tax to B2C performance and the limitation of the objective scope of this levy to the mere provision of digital services.

Going back to the analysis of the *web tax*, it could be objected that the foundation of the web tax is assumed a new wealth, to be identified in the value of the use of information technologies or the production and supply of services characterized by peculiar features concerning the elements characterizing VAT taxable transactions[301].

In the absence of a similar mechanism to the tax deduction, in order to mitigate the effects of the tax, its deductibility from corporate income on a cash basis according to Article 99 of the T.U.I.R. must be admitted.

The question of the protection of the Italian market is also highlighted, given that the tax on digital transactions, established with the manifest intention of recovering "wealth" produced in Italy and taken away from the tax sovereignty of our State, will also apply to the supply of digital services provided by Italian operators, so much to suggest the provision of a tax credit in favour of resident enterprises only, in the amount of the web tax poured[302].

Therefore, examined the characteristics of the tax, it is noted that this is not a real equalization levy, or rather a countervailing duty aimed at targeting the place of production of companies that do not discount adequate tax burdens, nor in the country of residence, nor in that of source[303], and this is because also non-residents with a permanent establishment in Italy are taxed. The web tax is rather an indirect tax ad valorem and special, as commensurate to the consideration of the transaction and on a single category of services[304].

Doubts also persist about the tax treatment of resident companies, which, in the light of web tax law, would have to pay this new tax in addition to ordinary direct taxation

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[301] The services affected by the new levy should be related to of specialty compared to the broad genus of services provided

subject to VAT, since they meet all the requirements to integrate the objective assumption of VAT, but they have a specificity which makes them distinctive.

[302] The tax credit has not been introduced, in view of the probable findings of incompatibility with the framework on State aid.

[303] Tomassini A., "L'incerta corsa alla tassazione dell'economia digitale", www.ipsoa.it 2018, pp. 169 ss.

[304] Gabelli M. *La nuova imposta sulle transazioni digitali,* op. cit.

without the granting of any tax credit. This has led to distortions and a competitive disadvantage for Italian companies.

This was also stressed by the Parliamentary Budget Office, which stated that the revenues of resident companies are subject not only to the new tax but also to other direct taxes in force in Italy.

This would be different for non-resident multinationals, for which the new tax could definitively fulfill their tax obligations in Italy. Moreover, large non-resident multinationals could more easily pass the tax on to the prices of services without reducing competitiveness[305].

Finally, the choice to include the quantitative parameter of the 3,000 transactions per year, regardless of the value of the individual transaction, was very perplexing because it is a non-economic parameter that can lead to inconsistent treatment of taxable persons and does not ensure a selection of the same following the legislator's intention to hit so-called Over The Top (*i.e.* Google, Facebook, Amazon) whereas, in the absence of a parameter of economic importance, undertakings which carry out many small operations could be taxed, while those which, despite a small number of services, receive large sums would be exempted[306].

Faced with these critical aspects and the lack of adoption by the Ministry of Economy and finance of the Implementing Decree provided by the Budget Law 2018, the web tax introduced by the latter has never been realized.

The Budget Law 2019 therefore dealt with the repeal of the digital transaction tax, which should have applied from January 2019.

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[305] Ufficio Parlamentare di Bilancio, *Pubblicato il Flash "La nuova imposta sulle transazioni digitali",* Comunicato stampa, 29 December 2017.

[306] Confindustria – Nota di Aggiornamento, *Legge di Bilancio 2018 – Misure fiscali d'interesse per le imprese,* 10 January 2018.

3. Budget law 2019

The Budget Law 2019 (Lax No. 145/2018), published in the Official Gazette on 30 December 2018, in addition to having retracted the digital transaction tax provided by the Budget Law 2018 – which, as we have seen, it has never been applied due to the lack of the necessary implementing Decree – introduced a tax on digital services (so-called ISD), inspired by the tax foreseen by the proposal of Directive COM (2018) 148 final. The ISD presents itself as an indirect tax on revenues from the provision of certain digital services such as online advertising, brokering and data transmission, with the national legislator's willingness to align the relevant national legislation with the provisions of the European Commission's proposal for a Directive of 21 March 2018[307].

As in the latter, also in the internal discipline of the ISD it is provided that the tax is applied on the revenues deriving from a series of digital services, expressly identified in paragraph 37 of Article 1 of the 2019 Budget Law. However while the Directive proposal highlighted the role of the user to delimit the scope of application of the tax to those services in which the user's involvement in the creation of value emerges more clearly, the 2019 Budget Law does not include such involvement, limiting itself to listing those services that it deems likely to create taxable wealth[308].

In particular, taxable digital services are divided into three types by paragraph 37:

(i) the delivery on a digital advertising interface targeted at users of the same interface;

(ii) the provision of a multilateral digital interface enabling users to be in contact and interact with each other, including with a view to facilitating the direct supply of goods or services;

(iii) the transmission of data collected by users and generated by the use of a digital interface.

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[307] Tomassini A. Di Dio A., "*Web tax sui servizi digitali: soluzione transitoria in attesa delle decisioni dell'OCSE*", in *Corriere Tributario*, 4/2019, p. 344.

[308] Di Tanno T., "*L'imposta sui servizi digitali si allinea alla proposta di Direttiva UE*", in *Il Fisco*, 4/2019, p. 1 – 326.

The taxable persons of the tax (paragraph 36) are all the subjects displaying business activity (therefore natural and juridical persons, independently from the type and the juridical form used), on condition that they exceed the threshold of demanded revenues *ex lege*, individually or at a group level, during a calendar year.

Specifically, taxable persons must jointly carry out:

(i) a total amount of revenues, everywhere realized, not less than 750.000.000 euros;

(ii) an amount of revenues deriving from digital services, in the territory of the State, not less than 5.500.000 euros.

Undertakings are taxable entities both if they exceed the thresholds indicated individually and if they exceed them at group level[309].

This statement shows a clear need to guard against possible abuses of parties. It seems even wider than that used by the Directive, where the "group" is identified in the limited scope of a consolidated (group)[310].

This reference to the "group" is questionable because there is no reference to a well-known conception of group. In fact, there is no reference to Articles 2359 or 2497 of the Civil Code, nor Article 25 ss. of the Legislative Decree 127/1991. Moreover, there is no mention to the provisions of Article 117 ss. of the T.U.I.R.[311] or those of article 70-*bis* of the VAT Decree[312].

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[309] Nucibella D., "*Web Tax 2019, punto e a capo",* in *Pratica Fiscale e Professionale*, 4/2019, p. 65.

[310] Article 4, par. 6 provides: «*If the entity referred to in paragraph 1 belongs to a consolidated group for financial accounting purposes, that paragraph shall be applied instead to the world revenues reported by, and taxable revenues obtained the within Union by, the group as a whole*» See European Commission, Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services, Brussels, 21 March 2018 COM (2018) 148 final.

[311] This Article, governing the national consolidation, defines which subjects are admitted to group taxation of companies set up altogether.

[312] Article 70 of the DPR 1972/633 which defines the subjective requirements for the establishment of a VAT group.

If the two requirements are met together the tax affects both non-resident companies and those resident in Italy, regardless of the nature of the customer. Therefore, both revenues from B2B services and those from B2C services are taxable[313].

Concerning the location of services, paragraph 40, in line with the provisions of the proposed EU Directive, emphasizes the predominant role of the user, identifying the State to which the benefit is to be attributed according to the place where the electronic device was used. In general, the rules on location and the criteria for connection to the territory follow those provided for in the Directive proposal, to which reference is made (Art. 5). Unlike the latter, the internal rule does not clarify when a certain electronic device is considered to be used in Italy, probably leaving the resolution of this issue to the Decree implementing the ministry of Economic and Finance and Ministry of Economic development[314].

The ISD is applied according to the performance achieved. It does not, therefore, take into account the time of collection, but only that of the emergence of the right to receive the amount due.

It does not distinguish between resident and non-resident persons. The latter, if they do not have a VAT identification number, are required to be assigned this identification if they realize the dimensional assumptions described above (paragraph 43).

The tax is applied at a rate of 3 %[315] on the total amount of taxable revenues deriving from the provision of digital services located in Italy. Revenues are assumed gross of costs and net of VAT and other indirect taxes. However, revenues from services provided to group companies (whether controlling, controlled or subject to common control) must be excluded from the overall amount.

The ISD is applied on a quarterly basis and, pursuant to paragraph 42, must be paid within the month following each quarter; the tax return is instead annual and must be submitted within the fourth month following the end of the tax period. Since taxable

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[313] Tomassini A. Di Dio A., "*Web tax sui servizi digitali: soluzione transitoria in attesa delle decisioni dell'OCSE",* in *Corriere Tributario*, 4/2019, p. 344.

[314] Gatto A., "*Web tax: disciplina italiana ed europea a confronto",* www.ipsoa.it, 8 gennaio 2019.

[315] Paragraph 41 of Article 1 Law No. 145/2018.

entities are only those undertakings which in the course of the tax period exceed the above-mentioned thresholds, the fact that the standard requires the payment of the tax within the month following each quarter entails for companies a forecast of the revenue achievable during the tax period and the obligation to start paying the ISD even if there is no certainty that at the end of the tax period, the thresholds will be exceeded and therefore they will be taxable[316].

The provisions laid down in the field of VAT shall apply mutatis mutandis for the purposes of establishment, penalties, collection and litigation.

In order for the ISD to enter into force and become fully effective, it was necessary to adopt a decree of the Ministry of the Economy and Finance, in agreement with the Ministry of Economic Development, laying down the provisions for implementing the tax.

The deadline for issuing the implementing decree was identified in paragraph 45 on 1 May 2019.

On the reasons for the failure to release the implementing decree, the Minister of Economy and Finance Giovanni Tria declared, during the hearing before the House and Senate Budget Committees of July 16 2019 on public finance trends, that the Government was waiting for decisions at European level to have agreed measures and that in any case it was ready to implement ISD from 2020.

However, the implementing decree was not issued.

4. Budget Law 2020 and the introduction of the "Digital Tax"

Set aside also in the version of the Budget Law 2019, the *Web Tax* has thus reappeared first in the so-called Tax Decree (D.L. No. 124/2019), then in Article 84 of the Budget Law 2020 of 29 and 31 October 2019, and finally in paragraph 678 of Article 1 of the Budget Law 2020 (Law No. 160/2019), which intervenes in the aforementioned Art. 1, paragraph 35 ss. of Law 145/2018.

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[316] Di Tanno T., "*L'imposta sui servizi digitali si allinea alla proposta di Direttiva UE",* op. cit.

In its final form, the levy, applicable at a rate of 3%, assumes the nature of an indirect tax on the gross revenues (net of VAT) arising from the supply of certain digital services. From an economic point of view, this is an indirect tax compared to a net profit tax[317], which affects the turnover[318] of the lender.

In its prior version[319], the legislator identified the macro-categories of taxable services[320]. Today, alongside them, there are also (paragraph 37-*bis* of Law No. 145/2018) provisions of exclusion of an objective nature intended to subtract from the scope of the levy some digital services even though they theoretically fall within the aforementioned macro-types.

From these macro-typologies (which are namely: the transmission on a digital interface of advertising aimed at users of the same interface[321]; the provision of a digital interface enabling users to interact with each other to facilitate the exchange of goods and services; and finally the transmission of data collected by users and generated by the use of a digital interface)[322] it is necessary to subtract, as mentioned above, those provided for by the exclusions referred to in the new paragraph 37-*bis* of Article 1 of Law No.

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[317] In these terms Assonime, circular n. 19 of 1 August 2018, p. 89, according to which "(...) ISD is, in truth, a very special indirect tax because it is levied on gross revenues but its presupposition is the wealth created for the benefit of digital companies by users present in the territory of the EU, while the revenues that these enterprises obtain in this territorial within are a mere proxy, expressive of the value brought by the users of any EU jurisdiction. As such, the ISD seems to determine - of course, from an economic and not legal point of view - effects which are approximate to those which would result from the introduction of a net profit tax, even though it is commensurate with the price at which the services are provided".

[318] Since it is an indirect tax (as confirmed by the reference to the VAT rules at the point of collection, establishment, penalties and litigation) for which there is no recourse, specifically related to the activity of the company, there should be no doubt about its deductibility for IRES and IRAP purposes.

[319] Version referred to in Law No. 145/2018 before the amendments made by the Budget Law 2020.

[320] Tomassini A.- Di Dio A., "*Web tax sui servizi digitali: soluzione transitoria in attesa delle decisioni dell'OCSE*", in *Corr. Trib.*, 4/2019, p. 344.

[321] This is the so called digital advertising referred to in Art. 3, par. 1, lett. a), of the proposal for a Directive). It should be considered that the advertising services in question usually give rise to the provision of data which, if properly collected and ordered, result in an aggregate (so-called Big Data), which in turn can be resold on a different and wider market, which the letter is in charge of. c) of paragraph 37 of Law no. 145/2018 (data transmission).

[322] It is referred to the so called Big Data ordered and transformed into commercial tools to profile the user, creating sales networks. The latter is the case in which the services guaranteed to users, formally free, are actually rendered in exchange for the supply, often unaware, of data of various kinds acquired by the same beneficiaries of the services. See among others S. Santoro, "La *Web tax* - profili di sistema", in *Giustizia Amministrativa*, 2019.

145/2018: examples are the direct supply of goods and services in the context of a digital brokering service; the supply of goods and services ordered through the website of the supplier of those goods and services when the supplier itself does not act as an intermediary[323]; the provision of a digital content to users of the interface. Moreover, are also excluded the provision of a digital interface for the management of services such as communication or payment, services provided by trading venues and systematic internalisers; loan and investment services provided by crowdfunding platforms subject to authorization and supervision and finally, for all these services, the transfer of the relevant data by the entities providing them.

Therefore, the purpose of the levy is to target those web subject that generate value by virtue of the user base of their digital activity: companies that use banners on sites or advertising content, those who, through their multilateral platforms, encourage interaction between users also for commercial reasons, and those who "comercialize" (*i. e.* make profits) the data taken from their digital activity. On the contrary, e-commerce or sharing music and video[324] are excluded.

The territorial assumption of the withdrawal is represented by the presence of the user in the territory of the State. The Budget Law 2020 did not amend paragraph 40 of Art. 1 Law No. 145/2018 according to which for a revenue deriving from the taxed digital service to be considered taxable in a given tax period, the user of the service must be located in Italy during that period.

The territoriality of the service is therefore linked to that of the device in the sense that the user of the service is considered to be present in the territory of the State if he uses in Italy the device that allows him to benefit from the service.

Moreover, filling a gap present in the previous discipline of the ISD, the new paragraph 40-*bis* of Art. 1, in line with the aformentioned Directive proposal, provides

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[323] According to paragraph 39-bis of art. 1 of the Law n. 145/2018 (inserted, precisely, by paragraph 678 of the Budget Law 2020), the fees for the provision of the services in question "include all charges paid by users of the multilateral digital interface, with the exception of those paid for the supply of goods or services which they economically constitute, operations independent of access to and use of the taxable service".

[324] In this case, more than the value extracted from Big Data, we are faced with the general provision of services (electronic) through digital means.

that the device is considered to be located in the territory of the State with reference mainly to the internet protocol address (IP) of the device itself or to another geolocation system, in compliance with the rules relating to the processing of personal data.

However, this criterion was not considered appropriate since the characteristics of the IP address do not appear to be at all suitable[325], especially when taking into account the consequences, in terms of the emergence of the tax base and its distribution between EU members. It is claimed that this is a conventional approach commonly used to determine the location of the user in the context of widespread business practices, nor it is possible to find a current definition of IP address within the European law.

Moreover, when a taxable service is provided in the territory of the State in the course of a calendar year, the total taxable revenue, according to the new the paragraph 40-*ter*, is the product of the totality of the revenue from digital services generated anywhere for the representative percentage of the part of those services linked to the territory of the State. And this percentage is determined differently depending on the type of digital services that can be taxed.

In particular, the percentage shall be:

- in the case of advertising services "the proportion of advertisements placed on a digital interface as a function of data relating to a user who consults such interface while it is located in the territory of the State";
- for the performance of access to a digital circuit, "if: (*i*) the service involves a multilateral digital interface that facilitates the corresponding sales of goods or services directly between users, to the proportion of the delivery of goods or services for which one of the users of the digital interface is located in the territory of the State; (*ii*) the service involves a multilateral digital interface of a type which does not fall under the number 1), the proportion of users who have an open account in the territory of the State allowing access to all or part of the services

[325] Pizzonia G. – Emma M., "La *Web tax* sulle prestazioni digitali gioca d'anticipo ma ha molte criticità", in *Il Sole - 24 Ore* del 21 January 2019.

available under the interface and who have used that interface during the calendar year in question";

- for the performance of data transmissions "to the proportion of users for whom all or part of the data sold were generated or collected during the consultation, when they were located in the territory of the State".

In this respect, it has been rightly pointed out that the territorial allocation of taxable revenues is thus made in the same way as factual parameters which, at least in terms of value, do not have a real connection with users.

In fact, the link established by the aforementioned paragraph 40-*ter* between the amount of revenue to be considered produced in the territory of the State and the number of advertising messages, the delivery of goods or services, the number of accounts opened or the number of users, appears rather short-lived and in any case such as not to allow to reliably share the values achieved worldwide[326].

As for the payment of the tax, it must be made by 16 February of the calendar year following that in which the taxed services were rendered. It is a levy of duration with a tax period equal to the solar year and is taken into account for the settlement of the tax of the performance of the service, irrelevant resulting in the collection (according to Art. 4, par. 5 of the cited proposal for a Directive).

It is also provided for by the new paragraph 44-*bis* of Art. 1 of Law No. 145/2018 a special accounting system that taxable persons must establish to collect monthly information on the revenue from taxable services, as well as the monthly quantitative elements used to calculate the proportions referred to in paragraph 40-*ter*. (that is, those necessary for the determination of taxable revenues in Italy).

Lastly, new is also the addition of the so-called "sunset clause" or closing rule, which now provides for the repeal of the tax as soon as it comes into force provisions resulting from international agreements on the taxation of the digital economy. In this way, Italy is fully in line with the work carried out on this subject by the OECD and the European Union itself, both committed to working out a global and widely shared solution

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[326] Carinci A., "*La fiscalità dell'economia digitale: dalla* "*Web tax alla (auspicabile) presa d'atto di nuovi valori da tassare*", in *Il Fisco*, 47-48/2019, p. 4511.

in the international context. In essence, not the implementation but the duration of the tax, its effectiveness, will be subordinated to the evolution of the international framework.

5. Critical issues

From a strictly internal perspective it has been noted that there are concerns about the criteria for determining taxable revenues as they related to devices located in the Italian territory.

Initially, it could be censored the selectivity of the levy, tied, as we have seen, to certain dimensional thresholds reachable only by a few non-resident subjects.

However, in the light of the constitutional case law, the reasonableness and/or non-arbitrary nature of the new form of taxation is easily sustainable because of the particular economic strength generally attributed, to the so-called OTT compared to other types of undertakings[327].

In terms of EU law, given its target group, ISD risks being a discriminatory measure to the detriment of the non-resident companies involved, acting under the EU's freedom to provide services, which, on the other hand, would be taxed more heavily than resident companies.

This is also due to the fact that ISD, on one hand, affects gross revenues and, on the other hand, must be considered as deductible from business income[328].

The size threshold may also result in indirect discrimination based on nationality potentially affecting fundamental freedoms, considering that, for the purposes declared

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[327] Constitutional Court, judgment no. 288/2019 on the additional IRES due for 2013 by credit and financial institutions as well as insurance institutions.

[328] See ECJ judgment of 12 June 2003 in Case C-234/01 Gerritse; Id., judgment of 5 July 2007 in Case C-522/04 Commission v Belgium; Id., 13 July 2016 in Case C-18/15 Brisal. The irrelevance of the foreign deductibility of the charge for the purposes of assessing its being a discriminatory measure v. C. Dimitropoulou, *The Digital Service Tax and Fundamental Freedoms: Appraisal Under the Doctrine of Measures Having Equivalent effect to Quantitative Restrictions*- in Intertax, Vol. 47, Issue 2, p. 207, according to which *“the potential granting of a deduction for the DST as an expense from the corporate income tax base in the origin Member State, does not offset the tax liability of the taxable person because it applies to the determination of the taxable income in the residence state and not on on the final tax liability (as a credit mechanism)”.*

by the law and the legislator, the levy is designed to tax the income of non-residents (otherwise not taxable in Italy on the basis of the rules on the taxation of business income) and will affect, at least for the overwhelming majority, these operators[329].

However, it should be observed that the tax not only affects large foreign companies on the web, but also many large Italian companies. In particular, the groups of large Italian publishing and telecommunications companies that sell advertising (such as Mediaset) exceed the turnover threshold of 750 million. This means that advertising carried by the concessionaires of these companies is also subject to the tax. The paradox would thus be that the advertising that the dealership of a large publisher obtains on the site of its own newspaper would be subject to the new tax.

The analogous French law is concerned about the problem since: a) specifies a national turnover threshold much higher than that of the Italian standard (25 million euros instead of 5,5); b) requires that such turnover derives from online services that are taxed (and not from generic online services) and c) specifies that the worldwide turnover of 750 million must relate to revenues from services. This would solve the problem since in Italy the thresholds provided by the standard are exceeded by these companies as they are part of groups that invoice in sectors other than those subject to taxation (automotive, health, paper publishing, TV, etc.). The fact that the issue has not been solved to date is due to the fact that this would result in a considerable loss of revenue. However, it is clear that the rule in its current form cannot survive and must be changed or interpreted appropriately by the Revenue Agency.

It should also be noted that the levy may be classified as State aid to resident enterprises operating in the sectors affected by it and not reaching the above-mentioned size thresholds[330].

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[329] Including European subsidiaries of US Web multinationals.

[330] See R. Mason - L. Parada, "*Digital Battlefront in the Tax Wars*", in *Tax Notes International*, 2018, pp. 1183 ss.: "*The revenue triggers are facially neutral; they formally burden neither nationality nor familiar proxies for nationality, such as tax residence. Nevertheless, they are so high that the taxable population is very likely to be mostly foreign when viewed from the perspective of any one-member state applying the digital tax. Domestic companies liable for digital taxes are likely to be foreign-parented, rather than domestic-parented* [...] *that effect might violate EU law as nationality discrimination. Likewise, selective features of unilateral digital taxes may violate the state aid rules*".

This is also reflected in the final report on Action 1 of the BEPS project, which states, concerning withholding tax on digital transactions, that for some countries EU law imposes comparable obligations - *i.e.* non-discrimination between resident and non-resident companies - this would not allow the application of a gross final withholding tax to non-resident suppliers, even if the rate is set at a very low amount.

Moreover, the same report argues that this type of levy could create a problem of compliance with the WTO agreements[331], in particular the General Agreement on Tariffs and Trade (GATT) (in case the digital transaction should be treated as a product) and the General Agreement on Trade in Services (GATS) (in case of digital transaction treated as a service).

In particular, the report notes that both agreements generally require foreign suppliers of goods (in the case of GATT) and services (in the case of GATS) to be taxed no less favourably than domestic suppliers. Also, the GATS provides for broad exceptions for the application of the provisions of the Tax Treaties and for the imposition of tax provisions aimed at ensuring fair or effective taxation of direct taxes.
On the contrary, the GATT contains no exceptions to national treatment obligations and simply prohibits parties from charging imported products higher fees than those that would apply to similar products manufactured on national territory[332].

It should be repeated that a unilateral initiative such as the one in question, not coordinated at least with the rest of the Union's partners, risks creating a phenomenon of multiple taxations[333].

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[331] on the question of the compatibility of the ISD with the WTO rules, the minutes of the public hearing of 19 August 2019 of the Office of the US Trade Representative and the Interagency Section 301 Commission of the Trade Act of 1974 concerning the French DST are of particular interest, tax subject to investigation pursuant to the aforementioned provision of the Trade Act of 1974 in order to verify whether it is intervention 'unreasonable or discriminatory'. or otherwise to which to react by unilateral actions against the import of products or services from France (by imposing a retaliatory charge) or by contesting, by means of a special procedure, the compatibility of the French DST with the WTO rules.

[332] OECD (2015), Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, paragraph 299, OECD Publishing, Paris.

333 On the inadequacy of the ISD of Union inspiration, among others, Stevanato D., "*La Web tax piace a tutti, ma ha un problema: è sbagliata*", in *Il foglio* del 12 settembre 2017, according to which you are in the presence of a new spannometric charge on gross product, selective in nature with a clear overlap with respect to VAT and the risk of a downstream translation into the prices of products and services.

Besides, ISD today finds itself having to live with an internal notion of a permanent establishment, including a significant economic presence (Art. 162, letter f-*bis*, of the T.U.I.R.), which could lead to taxation in our country of the same revenues affected by ISD.

It is also curious to note that, in an attempt to leave as a criterion for the territorial distribution of the taxable amount deriving from cross-border activities that of the physical presence (and in particular of the permanent establishment 'traditionally' intended), in a highly digitalised economic context, a tax of the ISD type is used, which in any case is based on another physical presence, this time of the user (rectius: of the device used by the user)[334].

In this way, it moves from a geographical requirement depending on the company to one depending on the market, or rather from taxation at origin to taxation at the destination. And this, as we have noticed, without however entrusting the identification of the country of destination to satisfactory criteria.

Another critical aspect of the Italian digital tax is the apparent contrast with the privacy policy. The law requires taxable entities to keep proof of transactions made with users who use Pcs, mobile phones or other electronic devices located in the territory of the Italian State. The device is considered to be located in the territory of the State with reference mainly to the internet protocol address (IP) of the device itself or another geolocation system (paragraph 40-*bis*). The problem is that the privacy policy gives the user the right not to be geolocated. From the point of view of technology, it is perhaps possible to geolocate a user who does not want to be geolocalized, but this would be a clear violation of the will of the user himself, which in all advanced countries is protected by privacy legislation[335]. It should also be noted that the fact of being located in Italy does not mean being resident in Italy and therefore subject to Italian taxation: in theory, it could happen that a German advertising company is taxed in Italy by a Chinese tourist in Italy.

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[334] Della Valle E., "*L'imposta sui servizi digitali: tanto tuonò che piovve di Eugenio della Valle*", in Il Fisco n. 5/2020, p. 1 – 407.

[335] For the Italian legislation: https://www.garanteprivacy.it/home/diritti/cosa-intendiamo-per-dati-personali.

It could also be argued that in the light of the substantive considerations set out above, the expected revenue estimate (EUR 708 million from 2020 onwards) seems excessive. Moreover, the similar French tax, which operates in a much more developed digital market, is attributed to a revenue of only EUR 500 million. The figure for Italy is calculated in the technical report on the government's amendment to the Budget Law for 2019.

The figure for Italy is calculated in the technical report on the government's amendment to the Budget Law for 2019.

The report starts from the estimate made by the European Commission for the revenue from the Digital Service Tax (4.7 billion for the EU as a whole); it applies to it Italy's share of GDP (11.2 percent in 2016) and adds "the revenue from the transmission of data collected from users, which also represents taxable revenue".

The estimate, however, does not take into account the many exclusions present in paragraph 37-*bis*.

For a more realistic assessment, it should be borne in mind that in essence the tax is intended to target revenues from part of e-commerce and online advertising made by companies that exceed the turnover thresholds (over 750 million overall and 5.5 million in Italy).

The revenue from the Italian tax will be very modest, at least in the hypothesis that the tax, appropriately amended or interpreted, really only affects the so-called web giants and not European or Italian companies and that it only applies to online advertising fees, *i.e.* the real revenue of companies such as Facebook and Google. Should there be any doubts of interpretation on these points, it seems likely that the rule will either be amended or interpreted in such a way that it is really and only applied to the revenues of web multinationals[336].

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[336] Recommendation G/1586/148/5 of 11 December 2019 which "commits the Government to make it clear that the tax on digital services applies only to entities engaged in business activities that generate revenue, both nationally and globally, from digital services". Senato.it. 2019. [online] Available at: <http://www.senato.it/service/PDF/PDFServer/DF/349217.pdf> [Accessed 1 May 2020].

Furthermore, it is unclear how the conflict with privacy law can be resolved concerning the crucial issue of the territorial location of the digital transactions that are to be taxed.

Finally, it must be borne in mind that the US Administration has already threatened actions against French, Italian and British digital taxes, in addition to the duties that had already been imposed or threatened on all European companies.

Minister Gualtieri has remembered that the Italian web tax will not have to be levied before February 2021 and has wished an international agreement in absence of which the Italian tax will be maintained.

In any case, an agreement at the European level is urgent.

SUMMARY AND CONCLUSION

The absence of consensus leads to unilateral measures. The effectiveness of these provisional measures is questionable. Some scholars recognise the legitimacy of short-term approaches that can put pressure on international organisations to speed up their coordination efforts, while others believe that they would fail to fix the interests of the needs of the sources[337], calling for serious reform. At the same time, many argue that "quick fix" solutions, such as the turnover taxation proposed by France, Italy and Spain, are the wrong way forward, as they "will trigger a contrary reaction from non-EU countries"[338].

At the OECD level, a group of countries argues against interim measures because there is no solid conceptual basis for such action on the basis of possible negative consequences, including the risk of over-taxation and obstacles to growth. Other countries argue that the current system cannot tax all the value generated in a third jurisdiction and that such measures would be justified in advance of a long-term solution as a means to restore equity, sustainability and public acceptability. The OECD does not recommend interim measures on digital taxation, but accepts an excise duty on electronic services if certain conditions relating to the design of the measures are met[339].

The OECD Interim Report sets out the main criticisms of the interim measures as follows: impact on investment, innovation and growth; impact on welfare; the potential economic impact of taxation on consumers and businesses; possibility of over-taxation; possible difficulties in applying a tax as an interim measure and compliance and administration costs[340].

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337 Dourado, A.P., '*Digital Taxation Opens the Pandora Box: The OECD Interim Report and the European Commission Proposals*', *Intertax*, Vol.46, No.6/7, pp.565-572, 2018.

338 Schippers, M.L., Verhaeren, C.E, '*Taxation in a Digitizing World: Solutions for Corporate Income Tax and Value Added Tax*', *EC Tax Review*, Vol.27, No.1, pp.61-66, 2018.

339 Taxasutra, "*Decoding OECD's Interim Report on Digital Economy*", 2018. Available at (http://www.taxsutra.com/experts/column?sid=936).

340 OECD Interim Report (2018) Tax Challenges Arising from Digitalisation, p.178-180.

Following the OECD, the potential target of unilateral measures should be enterprises with high levels of scale without mass, characterised by performing a profitable activity abroad for a reasonably long period of time, as well as business models based on user participation and network effects (e.g. Internet advertising and brokerage services). In addition, such measures should be clear, time-limited and targeted, minimising over-taxation, the impact on start-ups and costs and complexity, while respecting international duties.

The expansion of unilateral taxes causes uncertainty about the scope of the tax treaties, as it marks a departure from the standard categories by showing some hybridisation, in particular by combining elements of profit taxes with elements of consumption taxes[341]. If the tax measures are selective about the nature of the transaction and the location of the companies, tax policy may deviate from the company's behaviour and the attractiveness of the location of the respective jurisdiction may be affected.

In conclusion, global solutions at the OECD level would be preferable, but it is not certain that by 2020 a consensus will be reached on the rules on nexus and profit allocation. A multitude of uncoordinated and complex unilateral rules lead to the fragmentation of international tax rules.

A harmonised and balanced approach is necessary in order not to damage growth and technological progress in the EU[342]. Better coordination and an inclusive framework would help the EU and its Member States to address fiscal challenges in a digitised world.

Furthermore, the inclusion of the virtual permanent establishment in the CCCTB proposal could be seriously considered, despite some reservations about such allocation methods.

[341] Ismer, R., Jescheck, C., '*The Substantive Scope of Tax Treaties in a Post-BEPS World: Article 2 OECD MC (Taxes Covered) and the Rise of New Taxes*', *Intertax*, Vol.45, No.5, pp.382-390, 2017.
[342] International Tax Review (2017) Combining Technology and Talent for the digtial tax future.

CONCLUSION

The affirmation and constant development of the digital economy have determined the impossibility to subject to taxation the revenues produced by the digital multinational companies deriving from activities that, although they have a direct economic link with a given territory, they do not have a physical link with it.

Since digital goods are highly mobile or intangible, the physical presence of a company in the market country is often not required, which is in contrast to the outdated international tax system based on the condition of a connecting link to enforce jurisdiction for tax purposes.

Tax rules are traditionally based on the "permanent establishment" criteria: taxation is linked to the place where all or part of the economic activities are physically carried out. This framework of understanding of the economic activity subject to taxation is however inadequate in the digital age for at least two reasons[343]. First, it is increasingly difficult to establish the taxable presence (the so-called "nexus") of some companies, as digital business models allow the provision of digital services with a minimum physical presence in a given tax jurisdiction (so-called "scale without mass"). Secondly, the role of data and users and reliance on intangible assets that characterize the new digital business models call into question how and where value is created[344].

The main feature of online transactions is their absolute degree of immateriality, which makes the consequent manifestations of economic capacity hardly attributable to the territorial scope of a country that can then subject them to taxation: this difficulty gives rise to the risk of the production of a wealth not taxed for lack of a territorial assumption. In this context, the issue of taxation of digital enterprises has become very important in the light of the aggressive fiscal planning strategies put in place by digital companies which, by exploiting the immateriality of transactions carried out through the

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[343] OECD (2018), Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, p. 171.

[344] Michael Lennard (2018), Act of creation: the OECD/G20 test of "Value Creation" as a basis for taxing rights and its relevance to developing countries, *Transnational Corporations*, Vol 25, No 3 Special Issue.

network and the intangibility of the assets on which the digital economy is based, they manage to evade taxation by locating incomes in countries with privileged taxation.

The extent and speed of digitalisation along with aggressive tax planning schemes to shift profits to low-tax jurisdictions by Multinational Enterprises (MNEs), which was put under the spotlight by Luxembourg Leaks (Lux Leaks) put pressure on tax administrations to ensure fair taxation.

In recent years, significant initiatives have been undertaken by the OECD, the European Union, as well as many States, on the subject of the taxation of wealth deriving from the digital economy, to find a solution that allows establishing, for tax purposes, the place where economic activities are carried out and where value is created, through the provision of forms of taxation that disregard the *taxable presence* (identified with a permanent establishment) in the territory of the States in which digital undertakings are active.

This issue has been effectively addressed in all its aspects in the BEPS project, which has provided States with important tools to combat abusive dynamics. The reflection on the digital economy, already in the 2013 Action Plan, clearly seemed to go beyond the issue of abuse and address the need to intervene more deeply in the rules governing the exercise of taxing power. This was confirmed later, even after the BEPS project was concluded.

Moreover, on March 16, 2018, was published the interim report "*tax challenges arising from digitalisation*", which describes the challenges posed by the digitalization of the economy and the possible measures needed to address the critical issues. At the same time, the effectiveness of the measures adopted in the field of permanent establishment within the BEPS Project is stressed, which has been reflected in the choice made by many multinational companies (*e.g*. Google, Amazon) to transform their commercial structures in line with the indications suggested by the OECD.

In February 2019, the OECD published the document "*Addressing the Tax Challenges of the Digitalisation of the Economy*", with which a public consultation concluded on 6 March was launched, aimed at receiving new suggestions concerning the problems arising from the growing rise of the digital economy. The document sets out the

proposals to amend the rules on profit allocation and the territorial link criterion necessary to adapt the current legislation to the changes resulting from the digital economy.

However, the growing activism of the OECD in this area has been countered by an unexpected lack of action on the part of the European Union. In fact, after the preparation of a package of measures for the taxation of the digital economy (see the proposals of Directive COM (2018) 147 and COM (2018) 148), thus finds itself in a stalemate, caused by the opposition of some Member States, which to date seems difficult to overcome. The risk is therefore that the aforementioned proposals for a directive will not find, at least in the short term, implementation, turning into a project without concretization.

The so-called comprehensive solution[345] is a long-term solution, which the Commission considers to be the best response. This consists essentially in replacing the criterion of permanent establishment with the principle of "digital presence", also called "virtual permanent establishment" or "significant economic presence". It is suggested to create a system similar to the one currently in place in some federal states such as the United States and Canada, where redistribution of companies' profits between States takes place based on a formula ("apportionment formula") that takes into account several variables, such as sales, employment and value-added. In this way, it is possible to take into account the contribution that the destination States also make to the enterprise - a contribution which, in the case of the digital economy, is represented, for example, by the data made available by users - and to prevent governments from imposing taxes on goods or services produced elsewhere, which would constitute an obstacle to free trade between states.

Such a system, with a profit-sharing scheme between States, would have many benefits. It would be better suited to the way companies operate in the globalised economy and would help companies to interface with governments through greater simplicity and certainty. The use of the profit-sharing formula would also be an advantage in terms of ease of management for the various states: they would no longer have to dwell on "the

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[345] European Commission, Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, COM (2018)147 final, 21st March 2018.

nature of a particular production unit, considering whether or not it meets the criteria of a permanent establishment"[346].

But proposals of this nature do not find sufficient international consensus at the moment and for this reason, the European Commission has put forward a second proposal[347], the DST (Digital Service Tax), an "interim" tax which is easy to implement and which can give a signal that we need to move in the direction of an international agreement. It is a 3% tax on revenues generated by certain digital activities produced by companies with a worldwide turnover of at least 750 million euros and with revenues in the EU of at least 50 million euros.

This is particularly true in cases where demand is not very elastic, which is likely to be the case for companies like Google, Facebook and Amazon that have large economies of scale or network economies – also because they have the big data of millions of consumers and because there is an advantage for the user to be on the same platform as many other users. In these cases, the tax is passed on to the users and becomes an obstacle to the digital transformation of the economy which is one of the basic objectives of the public policies of the European Union.

Secondly, such a tax, especially if it is limited to large companies with very high turnover thresholds, exposes itself to accusations by the Americans that it is duty against specific US (and some Chinese) companies. Indeed, from economic substance and beyond its legal form, the DST is comparable to a duty on the import of certain digital services.

Finally, the international debate on the taxation of the digital economy included a series of autonomous initiatives undertaken by many States (United Kingdom, Italy, France, Spain), which they adopted, as a transitional solution, a tax on digital services.

The UK was the first in Europe to move with rules for the erosion of taxable income (also) through the misuse of digital service distribution networks. In 2015, almost

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[346] Ceriani V. e Ricotti, G. (2018). "The international coordination of corporate taxation: old solutions for new challenges?", LUISS Guido Carli School of European Political Economy Working Paper 5.

[347] *European Commission,* 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)148 final of 21st March 2018.

at the same time as the release of the first final report of the BEPS project, the United Kingdom introduced a new tax, the *diverted profit tax*, aimed at effectively combating multinationals that conceal their permanent establishment in the UK or otherwise escape the traditional definition of a fixed business location through digital infrastructure.

The Anglo-Saxon choice was probably in the sense of framing the taxation of the digital economy in a pathological key, introducing measures to counteract abusive phenomena (or allegedly such) carried out through the provision of services on web platforms. The distinctive feature of this line of interpretation is that the digital economy, in itself, is at the limits of legitimate tax planning to the extent that it allows a misalignment (as has often been indicated) between the place where the income realized and the place where it is subject to taxation.

Some other measures, such as Indian equalisation levy, are aimed at certain sectors (in the Indian case, advertising) and to non-residents only. Thus structured, they therefore seem to take on the function of real "duties", in the movement of services from one State to another; the fact that they have as their object services is not surprising when one considers the current reduction of the difference between goods and services, being qualified as such the so-called "digital goods". The OECD itself points out, however, that such measures are in danger of contravening obligations States' international treaties, which are not only incorporated into the double taxation conventions taxes (from which they could be exaggerated, given the structural diversity of taxes income), but also in trade conventions such as GATT and GATS.

Other measures, such as those adopted by France and Italy, are aimed indiscriminately at resident and non-resident companies and have a much more significant range of services, characterised by mere automation. As such, they therefore seem to take the form of real taxes on consumption or on the provision of services, which are very easily passed on to consumers (and which, moreover, apply to each transaction) without a compensatory, and even competitive effect, risking creating a "reverse" competitive disadvantage, to the detriment of resident and less digitalised companies.

These interventions, however, share a common goal and common thinking. First of all, the fact that digital enterprises, especially foreign ones, are subject to a lower

overall tax burden than non-digital enterprises: the objective is to restore neutrality, now between foreign and similar domestic suppliers, now between suppliers of certain digital goods and services and non-digital competitors.

In certain cases, such as the Indian one, the tax is constructed as a levy on specific services, which is borne only by non-residents; the tax therefore seems to share the logic of the duties, even though it is borne by services, and risks taking the form of a barrier to entry into the country. The equalizing purpose of the measure is, however, clear: the tax aims to increase the overall tax burden of foreign subjects compared to that borne by domestic entities not affected by the levy.

In other cases, such as the Italian and French one, this equalizing purpose is much more nuanced; the levy is due by persons equally resident or non-resident in the territory of the State, so that it does not lead to any realignment, acting as an additional indirect tax that insists on transactions carried out in a specific economic sector. Nor, as seen, could this levy be attributed to a compensatory effect of another kind, namely that of hitting companies (especially foreign ones) which, operating with digital structures, maintain a competitive advantage; it has been noted that such a tax even risks creating a "reverse" competitive disadvantage, to the disadvantage of resident and less digitised companies.

In other cases, which is what is evident in the intentions of Spain, which wants to introduce the European digital service tax, the logic still seems different. As pointed out, this levy burdens residents and non-residents and affects the aggregate of digital services characterized by a contribution of users in terms of value creation; it seems, therefore, that the provision of the digital service becomes the means to identify - and hit - a different, and entirely new form of "wealth", *i.e.* the value generated by the contribution of users. Thus, reconstructed in this way, the tax seems to lose all equalizing purposes and to act rather as a new, original and, if well-constructed, exempt from the criticism that can move to the previous two forms of taxation.

From what has been illustrated so far it is clear that, although the measures introduced by the various countries are different in structure and object, it is possible to trace common elements.

First of all, it seems clear that countries intend to invoke tax quotas in their territory, even when they act as market countries. From this point of view, the presence of customers in the country becomes an element of allocation of taxing power in that country.

These initiatives, however, have resulted in the creation of a myriad of web taxes within the different legal systems which, due to a lack of harmonisation, increase the risk of double taxation and in general of discrimination and conflicts between national law, this is an example of the recent case involving France and the United States. US President Donald Trump has bitterly contested the web tax introduced by the French government, considering it a discriminatory and incorrect measure, specifically aimed at targeting digital multinationals based in the United States. All this brings out the need for a supranational solution, unitary and shared, in the matter of taxation of the digital economy.

Also, these measures could entail several risks, including a negative impact on investment, innovation, growth and welfare, a potential shift in the economic impact of taxation on consumers and the possibility of over-taxation and implementation difficulties.

In conclusion, following the discussion of the digital economy and related tax issues, it is clear that the international and national legislative framework must be aligned with the new economic scenarios.

I believe that there is a need for greater cooperation from all the Member States that can establish common principles to deal with the well-established tax rulings that do not always follow the criteria of legality.

I reckon that remaining at a stalemate such as the current one can only further damage relations between individual States, which are being set against each other by corporate choices made by multinational companies concerning tax residence, without any interest in the Union but only about their profits to be preserved by the tax system.

The most important problems to be solved are related to the scope of the future standard itself. In fact, to date, no common solution has yet been reached on the most important aspects of taxation. It should also be borne in mind that it is not possible to

consider the turnover of a company as the only parameter of taxation, as many web companies generate value without large revenues. Another problem, which is slowing down the already exhausting process of digital taxation, is the priority of finding an agreement at the international level before the European level.

The complex debate on the European Commission's proposal on digital taxation suggests that there should be is a long way to go before consensus is reached on digital taxes.

It is becoming increasingly difficult to define a part of the economy as “digital” nowadays. For this reason, such a digital tax will probably not only tax a group of arbitrarily defined digital companies, but also a much larger set of companies. It would be a pity that a poorly designed tax would become a barrier to growth for innovative companies and damage the potential of digital services to improve the lives of individuals.

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