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CFE's Tax Top 5

Key tax news of the week

Brussels, 5 March 2018

EU Commission early draft on taxation of the digital economy

A draft European Commission text analysing potential avenues for taxation of the digital economy in the Single Market was published last week by Politico.

- **Short-term solution: Tax on gross revenue**

The draft discusses a temporary measure to tax the aggregated gross revenue of digital businesses at a single rate of 1 -5 percent. The levy would apply to digital firms with global revenue above €750 million, and annual EU revenue of €10 million or more. The measure is considered as an indirect tax to be levied annually on gross revenue with no deduction of costs, with revenue to be calculated based on the "exploitation of digital activities characterised by user value creation".

Revenue contemplated to be within the scope of the proposed tax includes services of data collection for the sale of targeted advertising, such as Google AdWords, "free" Spotify, Facebook, Twitter and Instagram, and intermediation services of making available digital marketplaces such as Airbnb and Uber, with the aim of taxing business "in the jurisdiction where value is created". The tax would therefore require self-reporting of the relevant data for calculating revenue and place of supply. The draft specifically contemplates that electronically supplied digital content would be outside the scope of the tax, which would therefore exclude Netflix or paid Spotify subscriptions. The rationale for this is set out in detail in the proposal. The tax is proposed to be collected making use of a "one-stop-shop" model.

- **Long-term measures: Digital PE**

The proposal further sets out that the ideal comprehensive solution to the issues posed by the digitalisation of the economy would be an agreed international approach defining digital permanent establishment and profit allocation rules for digital activities. The proposal is unlikely to be agreed in its current format between member states, and the comprehensive solution is also likely to face opposition, particularly given that the US recently set out its position that it does not believe digital business is so inherently different such that it warrants separate treatment by way of the creation of a special tax regime.

A finalised version of the draft is expected in late March.

EU Commission published final *Amazon* ruling

The EU Commission published on 26 February 2018 the non-confidential version of its *Amazon* State aid decision of October 2017 that had concluded a three-year investigation into the group's tax arrangements in Luxembourg. The Commission established that the Luxembourg tax administration endorsed a methodology of calculation of taxable profits of Amazon's Luxembourg operating company (Amazon sprl) that had in effect reduced Amazon's taxable basis by payment of non-arm's royalty. The tax ruling which approved the transfer-pricing report related to the above methodological parameters and the utilisation of the group's intangible assets was declared to be in breach of the State aid rules. The decision is under appeal at the Court of Justice, which pending the outcome, does not however prevent recovery of the assessed back-taxes.

- **The tax structure under scrutiny**

The Commission established that Luxembourg had granted State aid to the Amazon group (primarily to Amazon sprl "the operating company") by virtue of a tax ruling dated 6 November 2003 and extended in 2011. This tax ruling allegedly reduced Amazon's operating company tax liability by transferring non-arm's length royalty to its parent Amazon SCS for the use of the group's intangible property. Commission claim that this ruling endorsed a method of calculation of annual payments from the operating company to the holding company for the IP rights to the Amazon, which exceeded, on average, 90% of the operating company's operating profits. Due to the legal form of this entity, a Luxembourg limited partnership with US-based partners, and its look-through nature for tax purposes, alongside the methodological choices accepted in the transfer-pricing report, the royalty payment to the SCS from Amazon sprl was assessed as non-compliant with a market-based outcome and consequently contrary to the State aid rules.

Under Luxembourg's tax law, the operating entity is subject to corporate tax whilst the SCS is not due to the chosen legal form and a mismatch with US tax law. The taxation rights of SCS partners' profits thus belong to the United States, with the US tax liability subject to deferral. The Commission further claim that the SCS was not actively involved in the development the IP and was not engaged in management of risks, assets and functions that would justify the level of royalty it received. In this way, three quarters of Amazon's profits were unduly attributed to the partnership, where they remained untaxed. According to the Commission, the ruling that endorsed the methods for taxation of profits amounts to selective advantage for Amazon not available to other companies in a comparable factual and legal situation, an illegal practice under the State aid rules.

- **Further steps**

Commission have set out the methodology to calculate the back taxes initially estimated at €250 million, plus interest. An action for annulment of a Commission State aid decision does not have a suspensory effect, obliging the Luxembourg government to recover the assessed tax. Under EU law, assessed back taxes under State air rules are not a penalty, rather an assessment that levels the playing field, and does not penalise the operating company as a beneficiary of State aid.

The Netherlands Introduces New Royalties Tax

The Netherlands' government has introduced a new tax on royalties, to come into effect from 2021, which aims to discourage companies establishing "letterbox" or "shell" companies in order to avoid paying tax on royalties, as part of measures to "overturn the Netherlands' image as a country that makes it easy for multinationals to avoid taxation", according to Dutch Secretary of State for Finance Menno Snel.

The law will apply to payments made to entities based in jurisdictions on the EU "blacklist" of non-cooperative jurisdictions, or jurisdictions with either no or a low statutory tax rate. Additionally, the legislation will introduce increased substance requirements for resident holding, financing and licensing companies.

CFE Tax Advisers Europe Annual Forum "Fair Taxation of the Digital Economy"- Brussels 19 April

CFE Tax Advisers Europe's Annual Forum will focus on the fair taxation of the digital economy, outlining and discussing EU Commission's proposal due to be published in late March 2018.

The Forum will analyse the direct and indirect tax aspects of the digitalising economy. Three impressive panel of speakers include Maria Elena Scoppio, Head of VAT Unit and Bert Zuijdendorp, Head of Company Taxation Initiatives Unit, DG Taxation and Customs Union, European Commission. A full list of speakers, Forum registration & programme details is available on the link below.

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