AUSTRIA, FRANCE, AND ITALY TO INTRODUCE DIGITAL SERVICES TAXES

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Tags
Austria
Digital Services Tax
E.U.

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INTRODUCTION

The aim of a digital services tax is to subject companies offering digital services to taxation in the country where the service is provided. It is directed at use within a specific country and can affect search engines, video portals, or social media platforms selling advertising as it attempts to impose tax where the content is watched or clicked. Intermediary transport or accommodation, cloud computing, online gaming, and on-demand video services could also be subject to the tax, depending on how it is structured.

The general belief is that a digital services tax is directed at out-of-country providers of digital services, mostly based in the U.S. The logic is that out-of-country providers make huge profits in Europe but pay no tax there, whereas payments for digital services are often tax deductible by businesses in the countries where the services are used. A digital services tax is intended to change that equation.

After the European Commission proposal for a directive on the taxation of digital services was rejected, Austria and several other countries in the E.U. announced the unilateral introduction of digital services taxes. Such taxes raise a number of legal questions. This article addresses the commission proposal and questions raised by the unilateral approach that followed.

INTERNATIONAL TAXATION OF BUSINESS PROFITS

Non-European companies selling their goods or services to Europeans currently do not pay income tax on profits in Europe if the goods or services in question are not produced or performed in Europe and a taxable presence is not maintained in Europe. Nonetheless, they are subject to value added taxes, and if goods are sold in Europe, customs duties may be imposed. However, no customs duties are levied on digital services.

This reflects a basic concept of international trade: Corporate profits of a manufacturer that produces a product in one country and sells it for consumption or use in another country is generally taxed in the place of production. A similar rule applies to the provision of services performed in one country but consumed elsewhere. Thus, a German car manufacturer would not expect to pay corporate income tax on the sale of vehicles in the U.S., Africa, or South America in the absence of a taxable presence in those countries. (Typically, the German manufacturer sells to a distributor in the local country.) Similarly, an Austrian beverage producer does not pay Chinese tax on profits derived from the sale of beverages in China, and an Italian consultant does not pay Russian tax on profits earned by providing advice to

a Russian client. In the absence of a permanent establishment, a company in one country does not pay income tax in connection with the sales into a market located in a different country. The same is true for the performance of services in one country that benefits a consumer in a different country. In both instances, the location where activity occurs retains the principal right to impose income tax. The country where consumption occurs retains the right to collect turnover taxes and duties.

Bellwether U.S. companies such as Google, Amazon, Apple, and the like have paid little tax in the U.S. on global profits prior to U.S. tax reform at the end of 2017. While the U.S. was thought to have a global tax system in those earlier years, these companies engineered their facts and circumstances in a way that transformed the system into a territorial tax system. Only income from U.S. operations was taxed. Income from operations outside the U.S. was permanently deferred for financial accounting purposes and deferred indefinitely under tax law as long as repatriation events were avoided. This changed with the adoption of rules such as the mandatory deemed repatriation tax, the B.E.A.T. regime, and G.I.L.T.I.

However, the genie is out of the bottle as far as other countries are concerned. Developing countries and emerging economies, which historically did not have an administrative system in place to impose tax on a worldwide basis, determined that they are entitled to a share of the tax collected on income when profits arise from consumption of goods and services in their countries. The ability of industrialized nations to prevent developing countries from taxing these profits has sunset and with it the sanctity of the method of taxing business profits of a global enterprise.

THE E.U. AS A DEVELOPING COUNTRY

As far as digital services are concerned, the E.U. now appears to be in the process of adopting tax policies that were previously limited to developing countries. The vast majority of large digital service providers are based in the U.S. In this light, it makes sense from an E.U. perspective to collect consumption taxes related to the provision of digital services. Taxes on profits are not the right vehicle for raising tax revenue. E.U. countries that have adopted digital services taxes or are considering their adoption have focused on sales as the simple trigger for imposing tax. This means that customs duties and value added taxes are the mechanisms of choice. Limited constraints are imposed on the right of a country to impose a levy in connection with the sale of goods and services in the domestic market. In other words, the system of global taxation is in the process of being turned upside down in Europe in order to raise revenue from taxing companies that do not employ people who vote in local elections.

THE COMMISSION PROPOSAL

In March 2018, the European Commission proposed a council directive regarding an E.U.-wide digital services tax with the following features:[1]

- The tax would apply to revenues created from activities where users play a major role in value creation and which are the hardest to capture with current

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[1] 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.

tax rules. This would include revenues generated from (i) selling online advertising space, (ii) the performance of digital intermediary activities allowing users to interact with other users, thereby facilitating the sale of goods and services between them, and (iii) the sale of data generated from user-provided information.

- Tax revenues would be collected by the Member States where the users were located and would only apply to companies with total annual worldwide revenues of at least €750 million and E.U. revenues of at least €50 million.
- Taxable revenues obtained by an entity in a tax period would be treated as obtained in a Member State if users of the taxable service were located in that Member State.
- The tax rate would be 3%.

During the second half of 2018, Austria held the presidency of the Council of the E.U. One of Austria's main goals at the time was to forge a consensus among the Member States regarding the adoption of an E.U.-wide introduction of a digital services tax. However, nothing came of this approach as no unanimity of views existed. Sweden, Denmark, Finland, Malta, and Ireland raised concerns regarding the proposal.[2] In addition, Germany expressed concerns that the proposal could intensify the trade conflict with the U.S.[3] and proposed a lighter version of the tax that would be restricted to online advertisements. France expressed similar views at the time.[4] Tax directives require unanimous consent in the E.U.,[5] and neither proposal was approved.[6]

UNILATERAL APPROACHES

The U.K. introduced a national digital services tax in 2018.[7] The French,[8] Italian,[9] and Austrian[10] governments now plan to enact separate national digital services taxes. In each instance, the tax is justified by the national government as a means of taxing profits of low-taxed foreign companies. However, the digital services taxes are consumption taxes aimed at a very specific, narrowly-defined economic sector.

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[2] "EU-Digitalsteuer scheint *bis* Jahresende möglich," *Weiner Zeitung*, September 8, 2018.

[3] "EU-Digitalsteuer: Die wichtigsten Fragen und Antworten," *Futurezone*, October 30, 2018.

[4] "Deutsch-französischer Vorschlag für Digitalsteuer ist gestoppt," *Zeit Online*, December 4, 2018.

[5] Article 113 of the Treaty on the Functioning of the European Union.

[6] "EU States Fail to Agree Plans for Digital Tax on Tech Giants," *Financial Times*, November 6, 2018.

[7] HM Treasury, "Digital Services Tax: Budget 2018 Brief," October 29, 2018.

[8] "Frankreich führt ab 2019 Digitalsteuer im Alleingang ein," *Futurezone*, December 17, 2018.

[9] "Italy Prepares to Introduce Web Tax Worth €114 Million a Year," *The Local IT*, November 27, 2017.

[10] "Österreichische Regierung macht Ernst mit der Digitalsteuer," *DerStandard*, December 30, 2018; "Austria Ramps Up Push for EU-wide Digital Tax on Big Tech," *Financial Times*, July 15, 2018.

They are protectionist in nature, an approach currently in vogue internationally. No matter the spin given to these taxes by governments, consumers will bear the economic burden of these duties if the service providers pass the taxes on to the customers via the price. That is likely to occur when the provider has a monopoly, which more or less is the case for the specific companies that are targets of the digital services legislation.

While the introduction of protectionist measures may sound good to local voters, they often produce a backlash as individual countries focus on raising revenues by taxing foreign companies or the revenues generated by such companies as a result of local sales. Bad ideas are not one-way streets, and the concept of taxing foreign companies based on local advertising activity may be gaining traction in other sectors. European automobile companies, which are known to advertise globally, could be the next target.

To attack the trade impediments now under consideration by national governments, the O.E.C.D. seeks to find a worldwide solution for changing business taxation. The target date is 2020.[11] The U.S. is participating in this project to ensure that the final report will not be aimed solely at companies in the U.S. In that regard, the O.E.C.D. approach contrasts with the uncoordinated unilateral measures by individual states, which are aimed at specific foreign providers or industrial sectors. It is possible that the O.E.C.D. proposals will result in an increase of customs duties and value added taxes on imports.

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THE AUSTRIAN LEGISLATIVE PROPOSAL

The Austrian government published a legislative proposal in April 2019. This proposal, which is yet to be reviewed and resolved upon by the Austrian parliament, provides for the following:

- The tax will apply to online advertising directed to Austrian customers and appearing on the devices of users with an Austrian I.P. address.
- The tax will be incurred by the online advertising service provider, and a self-assessment must be payed to the Austrian tax office on a monthly basis.
- The tax base will be the price for the online advertisement.
- The tax rate will be 5%.
- The tax will enter into effect as of January 1, 2020.[12]

E.U. LAW RESTRICTIONS

If individual E.U. Member States begin to implement consumption taxes unilaterally, E.U. law may be infringed upon. Turnover taxes, indirect taxes, and excise duties are harmonized across the E.U. Digital services taxes that amount to a flat percentage of sales can distort competition and infringe upon pan-E.U. fundamental freedoms. Such taxes must treat all market participants equally and not obstruct

[11] "OECD: Löger sieht entscheidenden Fortschritt für globale Digitalsteuer," *APA OTS*, January 30, 2019.

[12] *Mayr*, Das neue Digitalsteuergesetz 2020, RdW 4/2019, 264.

cross-border services within the E.U., including fact patterns involving a U.S. company offering its services to Austrian, French, and Italian customers via a subsidiary in Ireland.

INTERFERENCE WITH DATA PROTECTION RIGHTS

U.S. companies that are taxed on the provision of services will be required to track where the user is located when services are used. This will lead to the creation of permanent records of the movement patterns of European customers in protection against claims of double taxation within the E.U. An open question is whether data protection rules will protect users against such data collection. At one level, data protection obligations do not apply if there is a statutory requirement to collect and store data related to the individual. At another level, the right to data protection may prevail over the obligation of a company subject to a digital services tax to comply with the tax law. In the crazy quilt pattern of domestic legislation that is likely to continue within Europe for a period of time, it would not be surprising for a government to argue that a services provider must destroy records showing place of use and then to argue for a penalty because of the absence of proper recordkeeping.

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