Digital taxation: OECD negotiations, tax residency of digital companies and a possible European Digital Tax

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The Committee on Economic and Monetary Affairs adopted the own-initiative report by Andreas SCHWAB (EPP, DE) and Martin HLAVACEK (Renew, CZ) on digital taxation: OECD negotiations, tax residency of digital companies and a possible European Digital Tax.

Challenges arising from the digitalisation of the economy

The report highlighted that current international corporate tax rules are based on principles which were developed in the early 20th century and that taxing rights are mainly based on the physical presence of companies. These rights are no longer suited to an increasingly globalised and digitalised economy, thus enabling numerous harmful tax practices that undermine public finances and fair competition.

A fairer allocation

On average, digital businesses face an effective tax rate of only 9.5 %, as opposed to 23.2 % for traditional business models. Given that the demand for digitalised services has exploded due to the obligation to operate many tasks remotely in the COVID-19 context, providers of such digitalised services have been placed in a more favourable position than traditional businesses, especially SMEs.

In this regard, Members call for new and fairer allocation of taxing rights for highly digitalised multinationals and a revision of the traditional concept of permanent establishment, as it fails to cover the digitalised economy. They stressed that users of online platforms and consumers of digital services are now central elements in value creation by highly digitalised businesses, and that they cannot be shifted outside a jurisdiction in the same way as capital and labour and should therefore be taken into account when defining a new tax nexus to provide an effective remedy against aggressive tax planning and tax avoidance.

According to Members, new solutions to taxing the digital economy should preferably tax profits, not revenues. There is a need to tax multinational corporations on the basis of a fair and effective formula for the allocation of taxing rights between countries according to the report.

A global multilateral agreement

Members called for an international agreement aiming for a fair and effective tax system. They welcomed the efforts in the G20/OECD Inclusive Framework (IF) to reach a global consensus on a multilateral reform of the international tax system to address the challenges of continued profit shifting and the digitalised economy. However, they regretted the fact that the deadline for an agreement, fixed for the end of 2020, was missed.

Negotiations within the IF need to be finalised as quickly as possible till mid-2021 in order to create a consensus among the 137 participating states for having a fair share of taxing the digital economy (pillar 1) and to agree on a global minimum tax that would address the remaining issues of base erosion and profit shifting (BEPS) (pillar 2).

The report called on the Commission and the Council to intensify the dialogue with the new US administration on digital tax policy with the aim of finding a common approach in the framework of the G20/OECD IF negotiations before June 2021.

A call for immediate EU action

It is regrettable that the failure of the G20/OECD Inclusive Framework (IF) to find a solution in October 2020 has prolonged the under-taxation of the digitalised economy.

The COVID-19 pandemic has largely benefited digitalised businesses, mostly those that were able to scale up their operations, while many other businesses, notably SMEs, have suffered, and that it has accelerated the transition to a digitalised economy, thereby further emphasising the need to find multilateral solutions to reform the current tax system in order to ensure that the digitalised economy makes a fair contribution.

Members stressed that tax challenges stemming from the digitalised economy are a global issue and that an agreement at the level of the G20/OECD states is urgently needed to make international coordination possible. They considered that an ambitious and harmonised international solution is preferable to a patchwork of national or regional digital taxes bearing potential risks and is significantly more likely to find unanimous support in the Council.

The report insisted therefore, that regardless of the progress of the negotiations in the G20/OECD IF, the EU should have a fall-back position and stand ready to roll out its own proposal for taxing the digital economy by the end of 2021.

A digital levy as a new EU own resource

Parliament has restated its commitment to the introduction of an EU digital levy as an own resource with large majorities in a series of reports and resolutions. The revenues of the EU digital levy would be intrinsically linked to the open borders of the single market and the ‘digital union’ and would therefore constitute a highly suitable and genuine basis for an EU own resource.

The report maintains that the revenue of the EU digital levy will be part of a basket of new own resources whose proceeds will at least be sufficient to cover, through the EU budget, the future repayment costs (principal and interest) arising from the Recovery Instrument’s grants component, expected to be around EUR 15 billion per year on average and a maximum of EUR 29.25 billion per year from 2028 until 2058, while avoiding a reduction in expenditure for EU programmes.

Lastly, the European Council is urged to endorse a resolute leadership role for the EU in the worldwide endeavour towards fairer taxation by taking swift and determined steps towards introducing a digital levy as an own resource in the course of 2021.