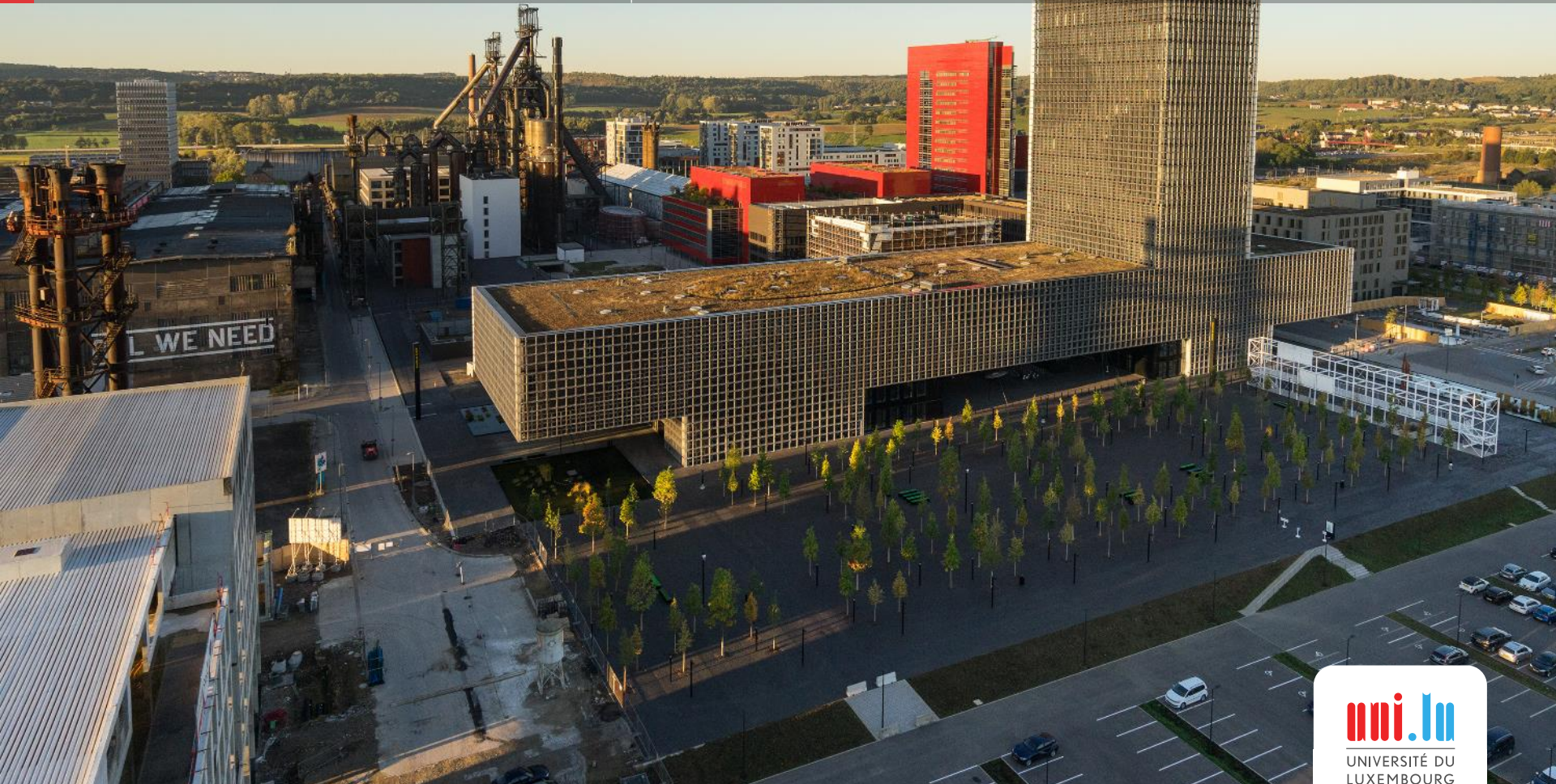


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Taxing intangible assets: issues and challenges for a digital Europe

Dr Elena Danescu, Research Scientist (C²DH)



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1. Introduction

- In today's economy, value creation is increasingly **based on knowledge and intangible assets**. This trend has gained momentum with the development of the service sector, the rise in competition as a **result of globalisation and deregulation**, and the impact of the digital revolution.
- Innovation has proven to be a **key factor in economic growth** (UNCTAD 2019, OECD 2016; European Commission 2017; Rifkin 2014; van Ark 2014).
- The recent global crisis, which revealed **the structural weakness of economies** and the globalisation of both financialisation and the digital economy, raised **questions about the nature of work, national sovereignty and territoriality** (Degryse 2017; TUAC 2017; Valenduc and Vendramin 2016), and gave rise to **unprecedented social, economic, fiscal, environmental and democratic challenges with the potential to cause societal upheaval** (Peña-Casas, Ghailani & Coster 2018; Méda 2016).

Potential impacts on value creation and capture from an expanding digital economy, by its components and actors

| ACTORS | | | | | |
|---------------------------|---|--|---|---|---|
| DIGITAL ECONOMY COMPONENT | Individuals (as users / consumers and workers) | MSMEs | Multinational enterprises / digital platforms | Governments | ECONOMY-WIDE IMPLICATIONS |
| Core, digital sector | <p>New jobs for building and installing ICT infrastructure.</p> <p>New jobs in telecom and ICT sector, especially ICT services.</p> | <p>Greater inclusion under suitable circumstances or spillovers/domestic linkages.</p> <p>Increased competition from cloud-service providers.</p> | <p>Investment opportunities for companies that meet high capital, technological and skills requirements.</p> | <p>Attracting investment.</p> <p>Tax revenues from the economic activity created.</p> | <p>Increased growth, productivity and value added.</p> <p>Employment creation.</p> <p>Investment and diffusion of technologies; R&D likely located in high-income countries.</p> <p>Mixed trade impacts.</p> |
| Digital economy | <p>New jobs in digital services, especially for highly skilled people.</p> <p>New forms of digital work, including for the less skilled.</p> | <p>New opportunities in digital ecosystems.</p> <p>Increased competition from foreign digital firms.</p> | <p>Enhanced productivity from data-driven business models.</p> <p>Greater control of value chains using platform-based business models.</p> <p>New opportunities in the sharing economy.</p> | <p>More tax revenue resulting from increased economic activity and formalization of enterprises.</p> <p>Lost customs revenue from digitalization of products.</p> | <p>Higher growth, productivity and value added.</p> <p>Employment creation/ losses.</p> <p>Higher investment.</p> <p>Aggregation of digital firms in some locations.</p> <p>Mixed trade impacts.</p> <p>Market concentration.</p> |
| Digitalized economy | <p>New jobs in ICT occupations across industries.</p> <p>Need for new skills as higher-value roles are redesigned using digital tools.</p> <p>Greater efficiency of services received.</p> <p>Job losses or transformation due to digitalization.</p> <p>Risk of worsened working conditions.</p> <p>Improved connectivity.</p> <p>More choice, convenience, customization of products for users and consumers.</p> <p>Lower consumer prices.</p> | <p>Platform-enabled market access.</p> <p>Reduced transaction costs.</p> <p>Risk of "race to the bottom" in markets vs. ability to find a niche.</p> <p>Lost opportunities due to automation (e.g. logistics, business processes).</p> <p>New roles in service provision.</p> <p>New business opportunities for digitalized enterprises.</p> | <p>Emergence of platform firms with data-driven models.</p> <p>Gains from efficiency, productivity and quality.</p> <p>Opportunities for the monetization of data.</p> <p>Increased competitive advantage of digital platforms</p> <p>Increased market power and control of data value chain.</p> <p>Leading digitalization in different sectors.</p> | <p>Increased efficiency of services through e-government.</p> <p>Increased revenue from customs automation.</p> <p>Unclear impact on tax revenue: increases from higher economic activity; losses from tax optimization practices by digital platforms and MNEs.</p> <p>Data-driven opportunities to meet various SDGs.</p> | <p>Growth through improved efficiency in sectors and value chains.</p> <p>Productivity improvements.</p> <p>Innovation impacts.</p> <p>Potential crowding out of local firms in digitally disrupted sectors</p> <p>Potential automation in low and medium-skill jobs.</p> <p>Wider inequality.</p> <p>Mixed trade impacts.</p> <p>Impacts on structural change.</p> |

Taxing intangible assets: issues and challenges for a digital Europe

1. Introduction

Public authorities, states, European organisations (the EU and the Council of Europe) and transnational and international bodies (UN, OECD, WTO, IMF) have a major role to play in **regulating the multi-dimensional potential of global growth** and defending against the problems inherent in these new, unavoidable processes.

2. Completing the European Digital Single Market (DSM)

- The creation of a free-trade area, within which goods, services, capital and people could move freely without hindrance, was an original goal of the Treaty of Rome (1957), ultimately resulting – via the Single European Act (1986) and the Treaty of Maastricht (1992) – in the Single Market (SM).
- **The SM is far from complete**, but it has incontestably given a significant boost to Europe’s GDP. Since 1992 it has been estimated that the European SM has raised EU GDP by 5% (Dahlberg 2015). **Three remarks:**
 - Since the mid-1990s, ICT have driven productivity gains and growth in the EU. The treaties do not contain specific provisions on ICT, but the EU has established a favourable framework for the information society.
 - Technological “convergence” has blurred the boundaries between telecommunications, broadcasting and IT.
 - Flows are essentially intangible, transnational and deregulated.

2. Completing the European Digital Single Market (DSM)

Since the early 2000s, the EU has endeavoured to set a specific set of rules for the single market in the digital area. **Milestones:**

2010 - A Digital Agenda for Europe

2010 - Europe 2020: A Strategy for Smart, Sustainable and Inclusive Growth

2015 - A Digital Single Market Strategy for Europe (DSM) – **Three pillars:**

- 1) Better access for consumers and businesses to online goods and services across Europe
- 2) Creating the right conditions for digital networks and services to flourish
- 3) Maximising the growth potential of our European Digital Economy

The impact of digital technologies in human and social terms are emphasised in the European Pillar of Social Rights .

The DSM should be considered not just as a series of regulations on technical and digital matters, but rather as a general context for new technologies (Nyman-Metcalf and Papageorgiou, 2018).

Taxing intangible assets: issues and challenges for a digital Europe

Overview of key measures and policy initiatives of the Digital Single Market Strategy

| POLICY AREA | MAIN PROPOSALS |
|---------------------|--|
| Access | <ul style="list-style-type: none">- Cross-border e-commerce: Harmonization of VAT and consumer protection, better enforcement of consumer rights, harmonized parcel delivery, end of “unjustified” geo-blocking- Temporary portability for audio-visual content across EU-borders- A reform of copyright legislation |
| Network Environment | <ul style="list-style-type: none">- Telecoms Single Market: Modernization of EU telecoms legislation- Data Protection and Privacy: Modernization of EU data privacy legislation (E-Privacy Directive)- Measures on Cyber Security- Inquiry into Online Platforms |
| Growth | <ul style="list-style-type: none">- Promote Digital Skills- Free Flow of Data: Abolishing barriers to the flow of data across Europe, European Cloud Initiative- Definition of Inter-Operability Standards |

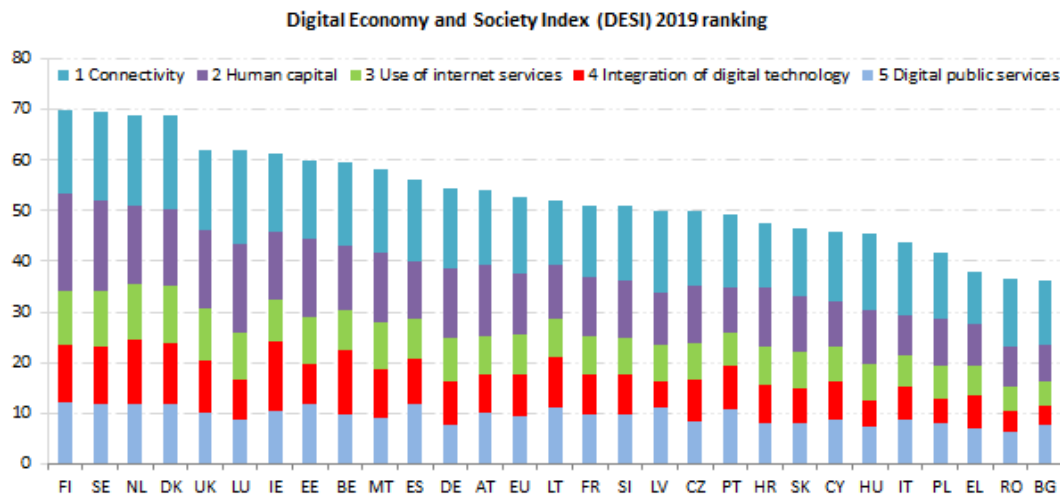
Taxing intangible assets: issues and challenges for a digital Europe

Digital technologies are not used and integrated in the same way in all the Member States, as shown by the Digital Economy and Society Index (DESI)

Performances – Internet usage, the adoption of digital technologies by companies and authorities, and the quality of transmission networks – improve progressively towards the north-west of the continent

The Digital Economy and Society Index (DESI)

DESI 2019



Source: <https://ec.europa.eu/digital-single-market/en/desi>

2. Completing the European Digital Single Market (DSM)

The digital transformation of Europe and the preservation of regulatory security remain political priorities.

- **Increased resources** allocated under long-term EU budget (Multiannual Financial Framework) for 2021-27 to support the DSM (main areas: advanced computing and data, artificial intelligence, cybersecurity, advanced digital skills). Synergies with other planned programmes - Horizon Europe, the Connecting Europe Facility and the European Regional Development and Cohesion Funds.
- While the aim of the DSM is not to compete with GAFA, the EU nevertheless intends to create a legal environment and a technological ecosystem that are conducive to innovation (“**technological sovereignty in key fields**”) and help consolidate its interests and fundamental values (“regulatory sovereignty”) (von der Leyen, 2019).
- ‘**The EU has entered into dialogue with partners worldwide** to maintain support in areas such as internet governance, intellectual property rights and common standards for future technologies (5G), and to seek agreements on convergence for the harmonisation of spectrum management’ (EPRS, 2019). **Some of the more sensitive regulatory issues:** the market power of platforms, personal data management and portability, the ethical use of algorithms (that has fuelled populism across the continent) –, and the taxation of digital goods and services.

3. Fiscal hurdles raised by the digital economy

Although not specifically expressed in the DSM proposals, **the plan for a “digital tax” is undoubtedly a priority for the European Commission**, to be developed within the Organisation for Economic Cooperation and Development (OECD). The importance of such a tax reflect that:

- 1) it goes far beyond the context of national and international taxation policies
- 2) its content is inevitably extremely varied, ranging from privacy and data protection to regulatory issues (tax collection and distribution, etc.) and accounting aspects

For public authorities, states and international organisations, **the aim is to find a solution that reconciles the new global digital economy with traditional principles relating to sovereignty, taxation and distribution**, some of which may no longer correspond with the realities of the modern world.

3. Fiscal hurdles raised by the digital economy

3.1. Introduction to fiscality

A country's approach to taxation is shaped by its history, customs and traditions, and its degree of regional and international integration. **While political sovereignty encapsulates the idea of supremacy, fiscal sovereignty is somewhat different** (Maître de la Motte 2012).

- Although the state is the primary holder of its own fiscal sovereignty, it may share this with other supranational entities (European and international organisations) or subnational entities (regions, local authorities) – especially in the area of indirect taxation –, but it cannot irrevocably waive its sovereignty over taxation. In federal states, there are two levels of fiscal sovereignty that correspond to the two levels of political sovereignty: the federal state and the federated entities.
- Because the internationalisation and globalisation of means of production at world level has not prevented the persistence of national state-based economies, we are witnessing a juxtaposition of fiscal sovereignties.

3. Fiscal hurdles raised by the digital economy

3.1. Introduction to fiscality

Sources of taxation:

- **The state** (the main source).
- **International arrangements (bilateral & multilateral)** designed to lay down standard rules for the signatory states, including:
 - the UNO and the OECD;
 - the World Trade Organization (WTO, formerly GATT);
 - the Treaty of Rome (1957) and subsequent EU treaties – the Treaty of Maastricht (Treaty on European Union, 1992) and the Treaty of Lisbon (Treaty on the Functioning of the European Union, 2007);
 - the Vienna Conventions on Diplomatic Relations (1961) and Consular Relations (1963).
 - the Convention for the Protection of Human Rights and Fundamental Freedoms (Council of Europe, 1950), which contains provisions on criminal tax law (Art. 6).

3. Fiscal hurdles raised by the digital economy

3.2. The origins (and weaknesses) of European taxation – a historical overview

The ECSC Treaty (1951) contained economic and social provisions designed to regulate the coexistence of six national systems and one supranational authority within a single geographical area.

Although the production and sales activities of coal and steel companies came under the remit of the supranational authority, they continued to be subject to national taxes and duties, which influenced the competitiveness of the respective industries.

The High Authority had no direct power over taxation, which remained the prerogative of individual countries (article 67 of the ECSC Treaty) .

The High Authority was responsible for protecting competing industries in the Member States and could “address a recommendation” to a given state, but this was not binding and gave the state the choice of appropriate methods to achieve the desired result.

These were the roots of the “original sin” of European fiscality.

3. Fiscal hurdles raised by the digital economy

3.2. The origins (and weaknesses) of European taxation – a historical overview

The Treaty of Rome (1957)

Community taxation particularly affects indirect taxes.

- EU harmonisation in the area of indirect taxation currently applies to value-added tax (VAT) and excise duties (tobacco and alcohol), and there is direct taxation on capital gains (capital duty).
- **The unanimity rule applies to voting on taxation.**
- Direct taxation is not within the scope of Community decision-making and remains the prerogative of Member States, which retain absolute sovereignty in this respect.

3. Fiscal hurdles raised by the digital economy

3.2. The origins (and weaknesses) of European taxation – a historical overview

The Treaty of Rome (1957)

- Taxation was seen as a sovereign right for states and the question was **sidestepped** because no agreement could be reached between the founding members.
- The treaty does contain a number of “**tax provisions**”, which confer powers on Community bodies and encourage the harmonisation of national tax legislation, at the very least a “minimal approximation. It creates the framework for a federal tax system with own revenue and a Community tax administration.
- **The treaty confers no fiscal powers on the Community** – subsequently the EU – that enable it to introduce taxes in the same way as a state.

3. Fiscal hurdles raised by the digital economy

3.2. The origins (and weaknesses) of European taxation – a historical overview

1958 - Attempts to harmonise corporate taxation.

1959 - The tax authorities in the EEC Member States set up three working groups to “review the feasibility of harmonising indirect levy legislation.

1960-1962 – The Neumark Report [calling for the abolition of fiscal frontiers and recommending both the introduction of a value-added tax (VAT*) and the harmonisation of corporate tax].

1962 – The first taxation directive of the EEC Commission.

1963 – The EEC Commission proposed a “**convergence clause**”, which would establish a method for the approximation of tax legislation.

3. Fiscal hurdles raised by the digital economy

3.2. The origins (and weaknesses) of European taxation – a historical overview

1964 -, “Initiative 1964” - an official timetable for the abolition of customs barriers.

1965 – Germany (supported by the Netherlands) submitted a working document to the Council of Ministers on tax harmonisation in Europe, proposing the abolition of fiscal frontiers by 1 January 1972.

1966 - The Segré Report (1966) on the development of a European capital market.

1967 - The first directive on indirect taxation (VAT).

1970 - The van den Tempel Report, which paved the way for the introduction of a traditional corporate tax system in the Community.

During the work of the Werner Committee (**March-October 1970**), which resulted in the plan by stages for an economic and monetary union in the Community (the Werner Report), taxation was a subject that was intrinsically linked to the ongoing discussions and prevailing divergent view.

3. Fiscal hurdles raised by the digital economy

3.3. Creating future benchmarks

- Given its specific characteristics – activities that are no longer dependent on their geographical location, the key role of platforms, the importance of network effects and the use of data –, **the digital economy differs markedly from the traditional economy** (OECD, 2015).
- Paradoxically, **the digital economy continues to be governed by traditional taxation**, which has proven to be **incomplete, insufficient** and a **source of injustice**.
- Within the applicable regulatory framework,. (There is often a discrepancy **digital companies are able to take advantage of some tax systems to minimise their taxation (tax planning), thereby gaining an undeniable comparative advantage and outperforming national companies** between where value is created and where tax is payable on the corresponding income – as can be seen with the example of GAFA) .

3. Fiscal hurdles raised by the digital economy

3.3. Creating future benchmarks

- Current taxation systems also **do not recognise new ways of generating income**, especially the role played by users in creating value for global digital platforms.
- Another difficulty comes with **the strategic preference of digital technologies to offer free services** (as a means of attracting and retaining users, who only begin to pay long after having used the service/application). The digital economy embraces this model and perpetuates it on a large scale (Anderson, 2010) – raising questions as to the most effective approach to encourage competition and innovation over the long term.
- **Proliferation of virtual currencies**. The issuance of these currencies is not regulated by a central bank but by private operators, with the aim of facilitating trade and maximising opportunities for value creation. In terms of taxation, virtual currencies make it easier to reduce the scope of monetary transactions and optimise their territorial allocation so as to optimise the distribution of related profits (Mersch, 2018; ECB, 2019).

3. Fiscal hurdles raised by the digital economy

3.3. Creating future benchmarks

Given the difficulties in neutralising tax avoidance and the challenge of taxing digital goods and services fairly, **the G20 asked the European Commission and the OECD** to begin work on reforming the European and international tax systems.

4. Towards global taxation of the digital economy

2013 - Following on from the report “**Addressing Base Erosion and Profit Shifting**” (**BEPS**), the OECD and G20 countries adopted a **15-point Action Plan** to tackle these practices, based on **three priorities** :

- 1) introducing coherence in the domestic rules that affect cross-border activities;
- 2) reinforcing existing international standards;
- 3) improving transparency

The European Commission immediately elaborated on this strategy with specific proposals.

Network:

- **Developing countries** participate in the OECD Committee on Fiscal Affairs.
- **Regional tax organisations** – the African Tax Administration Forum (ATAF), the Exchange and Research Centre for Leaders of Tax Administrations (CREDAF) and the Inter-American Center of Tax Administrations (CIAT) – worked in synergy with international organisations - the IMF, the World Bank and the UN.

4. Towards global taxation of the digital economy

2015 - the **Action 1 Report (“Digital Economy”)** of the BEPS Project and in the OECD/G20 Inclusive Framework on BEPS (135 countries and jurisdictions) aiming to:

- **develop standards** relating to BEPS (“tax must be declared and levied in the place where value is created”)
- address **procedural questions** (“BEPS planning strategies that rely on outdated rules or on poorly coordinated domestic measures will be rendered ineffective”)
- set up **methodological aspects** (improving data, evaluating and quantifying the impact of BEPS mechanisms, etc.).

2018 - with a mandate from the Finance Ministers of the G20 countries, the Inclusive Framework – via its Task Force on the Digital Economy (TFDE) – drew **up an Interim Report on the Tax Challenges Arising from Digitalisation** (highlighting **differing views between countries** as to how the digital transformation should be addressed) .

4. Towards global taxation of the digital economy

2019 – Public consultation aiming to gather as many reactions and contributions from external stakeholders as possible so as to develop a basis for negotiations with a view to **reaching a consensus in 2020**

2019 - The Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy adopted by the Inclusive Framework on BEPS.

Top priorities: the distribution of taxation rights between jurisdictions; clarification of some fundamental characteristics of the international tax system (the notion of “permanent establishment”, “the arm’s length” principle); the future of multilateral tax cooperation; the prevention of aggressive unilateral measures; the intense political pressure to tax multinational companies with a strong digital component.

4. Towards global taxation of the digital economy

2020 - the European Commission is set to propose a (new) interim tax for data services, designed to address the most urgent gaps and loopholes in the taxation of digital activities. This measure will ensure that those activities which are not currently taxed in an effective way will begin to generate immediate revenues for Member States.

The EU has led the way in adopting solutions for fair, effective taxation of digital goods and services, positioning itself at the forefront of efforts to develop a global solution in this area. Europe's proposals have also strongly inspired the work by the G20 and the OECD on taxing the digital economy.

5. Conclusion

- The globalisation of the digital economy, which has resulted in digital giants present in several different countries, is indicative of a **changing paradigm** (in terms of taxation & regulation of digital goods and services within a multilateral framework).
- This requires **consensus-based instruments and mechanisms** guided by **transparency and fiscal justice/equity** (when it comes to levying and redistributing taxes).
- It also needs to involve **an arbitration mechanism** to prevent companies based in several countries (through their headquarters, place of business, markets, etc.) from double or multiple taxation, thereby guaranteeing them stability and legal security.

5. Conclusion

- **New business models (based on platforms)** raise complex questions and issues related to innovation, competition, cybersecurity, the collection, management and use of data, how artistic creation is funded, etc.
- While **a global digital tax would significantly reduce the harmful competition** caused by the diversity of international tax systems, it would have **a negative impact on developing countries**, reducing capital by excluding transfers of profits between entities belonging to the same group.

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