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PROPOSAL

From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
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Subject:	Proposal for a COUNCIL DIRECTIVE laying down rules relating to the corporate taxation of a significant digital presence

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Proposal for a

COUNCIL DIRECTIVE

laying down rules relating to the corporate taxation of a significant digital presence

{SWD(2018) 81 final} - {SWD(2018) 82 final}

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

• Reasons for and objectives of the proposal

The digital economy is transforming the way we interact, consume and do business. Digital companies are growing far faster than the economy at large, and this trend is set to continue. Digital technologies bring many benefits to society and, from a tax perspective, they create opportunities for tax administrations and offer solutions to reduce administrative burdens, facilitate collaboration between tax authorities, as well as addressing tax evasion.

However, digitalisation is also putting pressure on the international taxation system, as business models change. Policy makers are currently struggling to find solutions which can ensure a fair and effective taxation as the digital transformation of the economy accelerates, and the existing corporate taxation rules are outdated to catch such evolution. The application of the current corporate tax rules to the digital economy has led to a misalignment between the place where the profits are taxed and the place where value is created. In particular, the current rules no longer fit the present context where online trading across borders with no physical presence has been facilitated, where businesses largely rely on hard-to-value intangible assets, and where user generated content and data collection have become core activities for the value creation of digital businesses. There is recognition at international level, by bodies such as the G20, that action is needed to adapt corporate tax rules to the digital economy. The Organisation for Economic Co-Operation and Development (OECD) examined this issue in the context of the OECD/G20 BEPS project[1]. At their meeting of March 2017, the G20 requested the OECD to deliver an interim report on the implications for taxation of digitalisation to the G20 Finance Ministers in April 2018. However, reaching an agreement at global level is likely to be challenging.

Such challenges were identified in the Communication of the Commission on '*A Fair and Efficient Tax System in the European Union for the Digital Single Market*' adopted on 21 September 2017. In this Communication the Commission set out its analysis of the tax challenges posed by the digitalisation of the global economy. This was followed by the conclusions adopted on 19 October 2017 by the European Council[2] which underlined the need for an effective and fair taxation system fit for the digital era and looked forward to appropriate Commission proposals by early 2018. The ECOFIN Council in its conclusions of 5 December 2017[3] also looked forward to appropriate Commission proposals by early 2018, "*taking into account relevant developments in ongoing OECD work and following an assessment of the legal and technical feasibility as well as economic impact of the possible responses to the challenges of taxation of profits of the digital economy.*"

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1 OECD report on BEPS Action 1"Addressing the Tax Challenges of the Digital Economy", 2015

2 European Council meeting (19 October 2017) – Conclusions (doc. EUCO 14/17).

3 Council conclusions (5 December 2017) – Responding to the challenges of taxation of profits of the digital economy (FISC 346 ECOFIN 1092).

The current corporate tax rules are built on the principle that profits should be taxed where the value is created. However, they were mainly conceived in the early 20th century for traditional 'brick and mortar' businesses and define what triggers a right to tax in a country ("where to tax") and how much of corporate income is allocated to a country ("how much to tax") largely based on having a physical presence in that country and without reflecting the value created by user participation in that jurisdiction. That means that non-residents for taxation purposes become liable to tax in a country only if they have a presence that amounts to a permanent establishment there[4]. However, such rules fail to capture the global reach of digital activities where physical presence is not a requirement anymore in order to be able to supply digital services. New indicators for significant economic presence are therefore required in order to establish taxing rights in relation to the new digitalised business models.

Once the business is taxable in a country, the profits generated by this business still need to be determined and attributed to this country. In the current corporate tax framework, transfer pricing rules are used to attribute the profit of multinational groups to the different countries based on an analysis of the functions, assets and risks within the value chain of the group. In the context of the taxation of business profits attributable to permanent establishment, a separate entity is hypothesised[5] and the OECD Transfer Pricing Guidelines apply by analogy. However the current rules, which were developed for traditional business models, do not reflect the fact that digital business models have different characteristics than traditional ones in terms of how value is created. This creates a distortion of competition and has a negative impact on public revenues. The digital economy relies heavily on intangible assets such as user data and advances data analytics methods in order to extract value from user data. These business patterns are becoming more and more the value drivers within multinational groups and are difficult to value. The challenge of identifying and valuing intangible assets as well as determining their contribution to value creation within a group requires new methods for attributing profit that better capture value creation in the new business models.

This proposal aims at addressing the issues raised by the digital economy by setting out a comprehensive solution within the existing Member States' corporate tax systems. It provides a common system for taxing digital activities in the EU which properly takes into account the features of the digital economy.

First, this proposal lays down rules for establishing a taxable nexus for digital businesses operating across border in case of a non-physical commercial presence (hereinafter: a "significant digital presence"). New indicators for such a significant digital presence are required in order to establish and protect Member States' taxing rights in relation to the new digitalised business models.

Second, this proposal sets out principles for attributing profits to a digital business. These principles should better capture the value creation of digital business models which highly rely on intangible assets.

[4] Article 5 of OECD Model Tax Convention on Income and on Capital.
[5] Article 7 of OECD Model Tax Convention on Income and on Capital.

This Directive, once implemented in Member States national legislation, will apply to cross-border digital activities within the Union, even if the applicable double taxation treaties between Member States have not been modified accordingly. It will also apply if a business established in a non-Union jurisdiction operates through a significant digital presence in a Member State, where there is no double taxation treaty in place between the Member State concerned and that jurisdiction.

- **Consistency with existing policy provisions in the policy area**

This proposal is part of the efforts being undertaken at EU and international level in order to adapt the current tax framework to the digital economy.

At international level, the challenge of ensuring that all actors in the digital economy are fairly taxed on their income was already identified under the Action 1 report of the OECD/G20 BEPS project, and in the OECD interim report on the taxation of the digital economy[6] which was presented to the G20 Finance Ministers in March 2018. The interim report reflects different options to address this challenge and the OECD intends to seek a consensus based solution by 2020.

The Commission acknowledges that the ideal approach would be to find multilateral, international solutions to taxing the digital economy, given the global nature of this challenge. The Commission is working closely with the OECD to support the development of an international solution. However, progress at international level is challenging, due to the complex nature of the problem and the wide variety of issues that need to be addressed, and to reach international consensus may take time. This is why the Commission has decided to take action. The present proposal is intended to contribute to the ongoing work at OECD level, which remains essential in order to reach a global consensus on this topic. By setting out the EU's vision on how to address in a comprehensive way the challenges of the digital economy, the proposed Directive will serve as an example to influence the international discussions on a global solution. The EU should encourage and support a move by global partners in that direction.

At EU level, this proposal builds on the numerous initiatives taken by the Commission with a view to ensuring fair and efficient corporate taxation in the Union[7].

In a broader context, it should be emphasised that the proposal for a Common Consolidated Corporate Tax Base (CCCTB) would be the optimal solution to ensure fairer and more efficient corporate taxation within the EU. However, the CCCTB with its current scope would not offer a structural solution to some of the important challenges in taxing businesses of the digital economy. This is because the CCCTB has a limited scope (it is mandatory only for large multinational companies) and because the definition of a permanent establishment in the CCCTB follows the one currently applied internationally. Moreover, the profit allocation rules (the formula apportionment) in the CCCTB may not sufficiently capture the digital

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6 OECD (2018), *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS*, OECD Publishing, Paris.http://dx.doi.org/10.1787/9789264293083-en.

7 COM (2015) 302 final

activities of a company. The rules on a taxable nexus for digital activities should be included in the CCCTB. Furthermore, with respect to allocating the profits of large multinational groups, the formula apportionment approach in the CCCTB should be adapted in order to effectively capturing digital activities. The Commission welcomes the amendments in the reports of the Committee on Economic and Monetary Affairs of the European Parliament on the Common Corporate Tax Base and the CCCTB as a good base for further work on ensuring a fair taxation of digital activities[8]. The Commission stands ready to work with Member States and the Parliament to examine how the provisions in this Directive can be incorporated into the CCCTB.

This Directive is part of a package that also includes a Recommendation to Member States for including corresponding rules on a significant digital presence and profit allocation in their double taxation treaties with third countries, a proposal for a Directive including an interim solution and a Communication setting the context and explaining the articulation between the proposals.

The Commission is recommending Member States to replicate the provisions included in this Directive in the double taxation treaties with third countries since, in case there is a double taxation treaty between a Member State and a non-Union jurisdiction, the rules of the applicable double taxation treaty may override the proposed provisions on a significant digital presence.

In addition the Commission is today putting forward a proposal for a Directive for an interim solution, the Digital Services Tax (DST), as a simple interim solution for the taxation of digital activities in the EU. The DST sets out a tax on the revenues derived from the provision of certain digital services.[9] The DST should apply on a temporary basis until a comprehensive solution is in place.

• Consistency with other Union policies

This proposal is also consistent with the Digital Single Market strategy[10], where the Commission committed to ensure access to online activities for individuals and businesses under conditions of fair competition, as well as to open up digital opportunities for people and business and enhance Europe's position as a world leader in the digital economy.

2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY

• Legal basis

Union's legislation concerning tax other than that on turnover falls within the ambit of Article 115 of the Treaty on the Functioning of the EU (TFEU). This provision stipulates that the

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8 Report of 22 February 2018 on the proposal for a Council directive on a Common Corporate Tax Base (COM(2016)0685 – C8-0472/2016 – 2016/0337(CNS)) and Report of 26 February 2018 on the proposal for on the proposal for a Council directive on a Common Consolidated Corporate Tax Base (CCCTB) (COM(2016)0683 – C8-0471/2016 – 2016/0336(CNS)).

9 Proposal for a Council Directive as regards a common system of a tax on the revenues resulting from the supply of certain digital services ('Digital Services Tax'), COM (2018) 148 final.

10 Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee and the Committee of the Regions 'A Digital Single Market Strategy for Europe' (COM(2015) 192 final of 6.5.2015).

measures of approximation under this article shall directly affect the establishment or functioning of the internal market.

- **Subsidiarity (for non-exclusive competence)**

This proposal complies with the principle of subsidiarity. As digital businesses are able to operate across borders without having any physical presence, both inside the Union and from third countries, uniform rules are needed to ensure that they pay taxes where they make profits. Given the cross-border dimension of digital activities an EU initiative is needed and adds value as compared to what a multitude of national measures could attain. A common initiative across the internal market is required for a direct and harmonised application of the rules on a significant digital presence within the Union so as to ensure a level-playing field for all Member States and provides taxpayers with legal certainty. Unilateral and divergent approaches by each Member State could be ineffective and fragment the single market by creating national policy clashes, distortions and tax obstacles for businesses in the EU. If the objective is to adopt solutions that function for the internal market as whole, the appropriate way forward is only through coordinated initiatives at EU level.

- **Proportionality**

The proposed Directive is necessary, suitable and appropriate for achieving the desired end. It does not imply a harmonisation of corporate tax rates in the EU and, therefore, it does not restrict Member States' capability to influence their desired amount of corporate tax revenues. It does not interfere with national policy choices in terms of the size of public sector's intervention and composition of tax revenues. It proposes a more efficient way to tax the digital activities of corporate taxpayers operating within the EU in view of a more efficient internal market.

- **Choice of the instrument**

Distortions in the internal market, as identified earlier, may only be tackled through binding legal rules and approximation of tax legislations through a common legislative framework. Soft law would be a suboptimal choice, as Member States would be free to not to implement it at all or it could lead to a piecemeal approach. Such an outcome would be highly undesirable. It would risk creating legal uncertainty for taxpayers as well as jeopardising the objectives for a coordinated and coherent corporate tax system in the internal market.

Based on Article 115 TFEU, *"the Council shall, acting unanimously ... issue directives for the approximation of laws, regulations and administrative provisions of the Member States as directly affect the establishment or functioning of the internal market*." The Treaty is therefore prescriptive that in taxation other than that on turnover (covered by Article 113 TFEU); legislation shall exclusively be in the form of directives.

3. RESULTS OF EX-POST EVALUATIONS, STAKEHOLDER CONSULTATIONS AND IMPACT ASSESSMENTS

- **Stakeholder consultations**

The consultation strategy has focused on three main groups of stakeholders: Member States' tax administrations, businesses and citizens. The two main consultation activities consisted in the open public consultation, which received a total of 446 replies over 12 weeks from 26 October 2017 to 3 January 2018, and a targeted survey sent to all EU tax administrations. As regards a comprehensive solution a proposal for a digital presence in the EU is the preferred approach for more than half of the respondents to the stakeholder consultation.[11] The preferred option coincided for both groups of stakeholders: 14 out of 21 national tax authorities as well as 58% of the 446 respondents to the open public consultation believe that the 'digital presence in the EU' proposal can best address the current problems related to the international taxation rules for the digital economy. Stakeholders were not asked explicitly on their preferred approach vis-à-vis non-EU jurisdictions. The members of the Platform for Tax Good Governance (made up of all EU tax authorities and 15 organisations representing businesses, civil society, and tax practitioners) were also informed about this initiative and their opinions sought out. Spontaneous contributions have also been taken into account.

- **Impact assessment**

The impact assessment for the proposal was considered by the Commission's Regulatory Scrutiny Board on 7 February 2018. The Board issued a positive opinion on the proposal together with some recommendations, which have been taken into account. The opinion of the Board, the recommendations and an explanation of how they have been taken into account are included in Annex 1 of the Staff Working Document accompanying this proposal. See Annex 3 for an overview of who would be affected by this proposal and how.

The impact assessment of this proposal examined both fundamental reform options and other options for changes within the existing international tax system. Due to either legal and/or political feasibility constraints, more fundamental reforms have been discarded as they represent unrealistic options at this stage. Instead the solution should focus on revision to the existing concept of a permanent establishment and profit allocation rules. At the same time, a solution only within the framework of the proposal for a CCCTB has been rejected on the grounds that it would have a too narrow scope for proposing a structural solution that would also have the chance to push for a solution beyond the EU. The preferred option to address the issue within the EU was therefore a standalone Directive to modernise permanent establishment rules and profit allocation rules.

4. BUDGETARY IMPLICATIONS

This proposal for a Directive will have no implications for the EU budget.

5. OTHER ELEMENTS

- **Implementation plans and monitoring, evaluation and reporting arrangements**

The rules in this proposal should be integrated into Member States' corporate income tax systems and the Commission's CCCTB proposal, and should ultimately be mirrored by corresponding changes in the OECD Model Tax Convention (OECD MTC) at international level. The Commission will monitor the implementation of the Directive once adopted and its application in close cooperation with Member States.

[11] See annex 2 of the Impact Assessment.

- **Detailed explanation of the specific provisions of the proposal**

Scope (Article 2)

This proposal affects corporate taxpayers that are incorporated or established in the EU, as well as enterprises that are incorporated or established in a non-Union jurisdiction with which there is no double taxation treaty with the Member State where a significant digital presence of the taxpayer is identified. The proposal does not affect enterprises that are incorporated or established in a non-Union jurisdiction with which there is a double taxation treaty in force with the Member State of the significant digital presence, so as to avoid causing any breaches of those double taxation treaties. This may be different if the applicable tax treaty with a non-Union jurisdiction includes a similar provision on a significant digital presence which creates similar rights and obligations in relation to that non-Union jurisdiction.

Definitions (Article 3)

This Article provides definitions of various concepts necessary for applying the provisions in the Directive (amongst others digital services, digital interface, revenues, entity, user and tax period).

A digital service is a service that is delivered over the internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention. This definition corresponds to the definition of 'electronically supplied services' in Article 7 of the Council Implementing Regulation (EU) No 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, and includes the same kind of services.

In order to exclude a taxable nexus based on the place of consumption only, the mere sale of goods or services facilitated by using the internet or an electronic network is not regarded as a digital service. For example, giving access (for remuneration) to a digital marketplace for buying and selling cars is a digital service, but the sale of a car itself via such a website is not.

Involving minimal human intervention means that the service involves minimal human intervention on the side of the *supplier* without any regard to the level of human intervention on the side of the user. A service shall also be regarded as requiring only a minimal human intervention in situations where the supplier initially sets up a system, regularly maintains the system or repairs it in cases of problems linked with its functioning.

Significant digital presence (Article 4)

The concept of a significant digital presence is intended to establish a taxable nexus in a jurisdiction. Therefore, it should be regarded as an addition to the existing permanent establishment concept. The proposed rules for establishing a taxable nexus of a digital business in a Member State are based on revenues from supplying digital services, the number of users of digital services or the number of contracts for a digital service. These criteria are proxies for determining the 'digital footprint' of a business in a jurisdiction based on certain indicators of economic activity. They should reflect the reliance of digital businesses on a large user base, user engagement and user's contributions as well as the value created by users for these businesses. The criteria should cater for different types of business models. Digital business models are very heterogeneous. Some may have a very large user base while others may have a smaller user base, but may still have significant user contributions if each individual user contributes a large value. Furthermore, the criteria should ensure a comparable treatment in different Member States, irrespective of their size, and leave out trivial cases.

For the three user-based criteria mentioned above (revenues, number of users and number of contracts) different applicable thresholds are set. There is a significant digital presence in a Member State if one or more of the following criteria are met: if the revenues from providing digital services to users in a jurisdiction exceed EUR 7 000 000 in a tax period, if the number of users of a digital service in a Member State exceeds 100 000 in a tax period or if the number of business contracts for digital services exceeds 3 000.

As explained in the Impact Assessment[12] it is essential that each threshold is set sufficiently high to safely exclude small cases where profits attributable to a digital presence would not even cover the tax compliance cost for a permanent establishment, thus to ensure proportionality of the measure while operating these three alternative thresholds. The revenue threshold is set to cover the estimated compliance costs for operating an additional permanent establishment, even at low rates. The threshold regarding the number of users should reflect a similar value in monetary terms based on average revenues per user. The threshold on the number of business contracts should reflect that only 'business-to-business' contracts should be taken into account as the value represented by these contracts is likely to be more substantial than that of contracts concluded with individuals. Therefore, a threshold on the number of business-to-business contracts should be considerably lower than a user-based threshold.

Profits attributable to the significant digital presence (Article 5)

The proposed rules for allocating profits to a significant digital presence are built on the current framework applicable to permanent establishments. They confirm the principle whereby a significant digital presence should be attributed the profits that it would have earned through certain significant economic activities performed via a digital interface, in particular in its dealings with other parts of the enterprise, if it had been a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the assets used, functions performed, and risks assumed. Therefore, the authorised OECD approach (AOA) remains the underlying principle for attributing profits to a significant digital presence. This said the framework needs to be adapted in a consistent manner, to reflect the way value is created in digital activities. Indeed, in the functional analysis of the permanent establishment, the criterion of significant people functions relevant to the assumption of risk and to the economic ownership of assets in the context of digital activities is not sufficient to ensure a profit attribution to the significant digital presence that reflects the creation of value. This situation occurs where a significant

[12] In section 6.3.

digital presence operates through a digital interface without any physical presence in a certain jurisdiction or where no significant people functions are performed in the jurisdiction of the significant digital presence.

In the functional analysis of the significant digital presence, activities undertaken by the enterprise through an digital interface related to data and users should be considered economically significant functions relevant to the attribution of economic ownership of assets and risks to the significant digital presence. The attribution of profits should take into account the development, enhancement, maintenance, protection and exploitation of intangible assets in the performance of the economically significant activities by the digital presence even if these are not linked to people functions in the same Member State.

For example, in attracting new users to a social network, the set of intangible assets that would be attributable to the business of the social network plays a key part in guaranteeing the positive network externalities, i.e. that the users are able to connect to a large number of other users. The enlargement of the network which is achieved through the significant digital presence enhances that same set of intangible assets. This set of intangibles would be further enhanced by the processing of user-level data to enable the social network to sell advertising space at a premium since the advertising space is customised to the interests of the users.

It follows that the functions related to the development, enhancement, maintenance, protection and exploitation of unique intangibles would be typical to a significant digital presence. Each of the economically significant activities contributes to the value creation in the digital business models in a unique manner and is an integral part of these models. The profit split method would therefore often be considered as the most appropriate method to attribute profits to the significant digital presence. In this context, possible splitting factors could include expenses incurred for research, development and marketing (attributable to the significant digital presence *vis-à-vis* the expenses attributable to the head office and/or any other significant digital presences in other Member States) as well as the number of users in a Member State and data collected per Member State.

The proposed rules only lay down the general principles for allocating profits to a significant digital presence as more specific guidelines on the allocation of profits could be developed at the appropriate international fora or at EU level.

2018/0072 (CNS)

Proposal for a

COUNCIL DIRECTIVE

laying down rules relating to the corporate taxation of a significant digital presence

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 115 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Parliament[13],

Having regard to the opinion of the European Economic and Social Committee[14],

Acting in accordance with a special legislative procedure,

Whereas:

(1) Rapid transformation of the global economy as a result of digitalisation is putting new pressures on corporate tax systems both at Union level and internationally, and calling into question the ability to establish where digital companies should pay their taxes and how much they should pay. Although the need to adapt corporate tax rules to the digital economy is recognised at international level by bodies such as the G20, reaching an agreement at global level is likely to be challenging.

(2) The Base Erosion and Profit Shifting (BEPS) Action 1 report on "Addressing the Tax Challenges of the Digital Economy" released by the OECD in October 2015 set out various different approaches for taxing the digital economy which were further examined in the OECD "Tax challenges Arising from Digitalisation – Interim Report 2018". As the digital transformation of the economy accelerates there is a growing need to find solutions to ensure a fair and effective taxation of digital companies.

(3) The Commission Communication on "A Fair and Efficient Tax System in the European Union for the Digital Single Market" adopted on 21 September 2017 stated that new international rules are needed specific to the challenges raised by the digital economy in order to determine where the value of businesses is created and how that value should be attributed for tax purposes. These new rules would entail reform of the existing international tax rules on the definition of a permanent establishment and the profit attribution applicable to digital activities.

(4) The European Council Conclusions of 19 October 2017 underlined the need for an effective and fair taxation system fit for the digital era and looked forward to appropriate Commission proposals by early 2018.[15] The ECOFIN Council

13 OJ C , , p.
14 OJ C , , p. .
15 European Council meeting (19 October 2017) – Conclusions (doc. EUCO 14/17).

Conclusions of 5 December 2017 underlined that a globally accepted definition of permanent establishment and the related transfer pricing and profit attribution rules should also remain pivotal when addressing the challenges of taxation of profits of the digital economy" and encourages "close cooperation between the EU, the OECD and other international partners in responding to the challenges of taxation of profits of the digital economy.[16]

In this regard, Member States should be required to include rules in their national corporate income tax systems in order to exercise their taxing rights. Therefore, the various applicable corporate taxes in the Member States should be clarified. These rules should extend the definition of a permanent establishment and establish a taxable nexus for a significant digital presence in their respective jurisdictions. In addition, general principles for allocating taxable profits to such a digital presence should be laid down. In principle, those rules should apply to all corporate taxpayers irrespective of where they are tax resident, whether in the Union or elsewhere.

(5) However, the rules should not apply to entities that are tax resident in a non-Union jurisdiction with which the Member State of the significant digital presence has a Double Tax Convention in force, unless the Convention includes provisions on a significant digital presence which creates similar rights and obligations in relation to the non-Union jurisdiction as are created by this Directive. This is to avoid any conflict with Double Tax Conventions with non-Union jurisdictions, given that non-Union jurisdictions are not generally bound by Union law.

(6) In order to provide for a robust definition of a taxable nexus of a digital business in a Member State it is necessary that such a definition is based on the revenues from the supply of digital services, the number of users or the number of business contracts for digital services. The applicable thresholds should reflect the significance of the digital presence for different types of business models and accommodate the different degrees of contribution to the process of value creation. Furthermore, they should ensure a compatible treatment in different Member States, irrespective of their size, and leave out trivial cases. The sale of goods or services which is facilitated by using the internet or an electronic network should not be regarded as a digital service within the meaning of this Directive.

(7) To enable an enterprise's significant digital presence to be taxed in another jurisdiction in accordance with the domestic law of that jurisdiction, it is necessary to establish the principles of attributing profits to that significant digital presence. The rules should be built on the current principles for profit attribution and be based on a functional analysis of the functions performed, assets used and risks assumed by a significant digital presence in performing its economically significant activities through a digital interface. Particular attention should be paid to the fact that a significant part of the value of a digital business is created where the users are based and where the data related to the users is collected and processed as well as to where the digital services are provided. Since economically significant activities performed by a significant digital presence contribute in a unique manner to value creation in digital business models, the profit split method should normally be used for arriving at a fair allocation of profits to the significant digital presence. However, this should not prevent a taxpayer from using an alternative method in line with internationally accepted principles if the taxpayer can prove that, based on the outcome of the functional

[16] Council conclusions (5 December 2017) – Responding to the challenges of taxation of profits of the digital economy (FISC 346 ECOFIN 1092).

analysis, an alternative method in line with internationally accepted principles is more appropriate. It is also essential that the profit splitting factors bear a strong correlation with the creation of value.

(8) A key objective of this Directive is to improve the resilience of the internal market as a whole in order to address the challenges of taxation of the digitalised economy. This objective cannot be sufficiently achieved by the Member States acting individually because digital businesses are able to operate cross-border without having any physical presence in a jurisdiction and rules are therefore needed to ensure that they pay taxes in the jurisdictions where they make profits. Given this cross-border dimension an initiative at Union level adds value in comparison with what a multitude of national measures could attain. A common initiative across the internal market is required to ensure a harmonised application of the rules on a significant digital presence within the Union. Unilateral and divergent approaches by each Member State could be ineffective and fragment the Single Market by creating national policy clashes, distortions and tax obstacles for businesses in the Union. Since the objectives of this Directive can be better achieved at Union level, the Union may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve those objectives.

(9) It is necessary that any processing of personal data carried out in the context of this Directive, should be conducted in accordance with Regulation (EU) 2016/679 of the European Parliament and of the Council[17], including obligations to provide appropriate technical and organisational measures to comply with the obligations imposed by that Regulation, in particular those relating to the lawfulness of the processing, the security of the processing activities, the provision of information and the rights of data subjects, data protection by design and by default. Whenever possible, personal data should be rendered anonymous.

(10) The Commission should evaluate the implementation of this Directive five years after its entry into force and report to the Council thereon. Member States should communicate to the Commission all information necessary for this evaluation. An advisory DigiTax Committee should be established to examine questions on the application of the Directive.

(11) In accordance with the Joint Political Declaration of 28 September 2011 of Member States and the Commission on explanatory documents[18], Member States have undertaken to accompany, in justified cases, the notification of their transposition measures with one or more documents explaining the relationship between the components of a directive and the corresponding parts of national transposition instruments. With regard to this Directive, the legislator considers the transmission of such documents to be justified.

(12) Member States should be required to apply the provisions of this Directive from the next tax period starting after the transposition deadline. This is to ensure that the new provisions begin to apply in each Member State from a date that is as closely aligned

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17 Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) (OJ L 119, 4.5.2016, p.1).

18 OJ C 369, 17.12.2011, p. 14.

as possible, but taking into account the fact that different Member States may have different tax periods,

HAS ADOPTED THIS DIRECTIVE:

CHAPTER I

SUBJECT MATTER, DEFINITIONS AND SCOPE

Article 1

Subject matter

This Directive lays down rules extending the concept of a permanent establishment, as it applies for the purposes of corporate tax in each Member State, so as to include a significant digital presence through which a business is wholly or partly carried on. This Directive also establishes certain principles for attributing profits to or in respect of a significant digital presence for corporate tax purposes.

Article 2

Scope

This Directive applies to entities irrespective of where they are resident for corporate tax purposes, whether in a Member State or in a third country.

However, 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, this Directive applies only 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.

Article 3

Definitions

For the purposes of this Directive, the following definitions shall apply:

(1) 'corporate tax' means one of the corporate taxes listed in Annex I or a similar tax subsequently introduced;

(2) 'digital interface' means any software, including a website or a part thereof and applications, including mobile applications, accessible by users;

(3) 'Internet Protocol (IP) address' means a series of digits assigned to networked devices to facilitate their communication over the internet;

(4) 'user' means any individual or business;

(5) 'digital services' means services which are delivered over the internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology, including in particular:

(a) the supply of digitised products generally, including software and changes to or upgrades of software;

(b) services providing or supporting a business or personal presence on an electronic network such as a website or a webpage;

(c) services automatically generated from a computer via the internet or an electronic network, in response to specific data input by the recipient;

(d) the transfer for consideration of the right to put goods or services up for sale on an internet site operating as an online market on which potential buyers make their bids by an automated procedure and on which the parties are notified of a sale by electronic mail automatically generated from a computer;

(e) Internet Service Packages (ISP) of information in which the telecommunications component forms an ancillary and subordinate part, in other words packages going beyond mere internet access and including other elements such as content pages giving access to news, weather or travel reports, playgrounds, website hosting, access to online debates or any other similar elements;

(f) the services listed in Annex II.

Digital services shall not include the services listed in Annex III or the sale of goods or other services which is facilitated by using the internet or an electronic network.

(6) 'revenues' means proceeds of sale and of other transactions, net of value added tax and other taxes and duties collected on behalf of government agencies, whether of a monetary or non-monetary nature, including proceeds from disposals of assets and rights, interest, dividends and other profits distributions, proceeds of liquidations, royalties, subsidies and grants, gifts received, compensations and ex-gratia payments. Revenues shall also include non-monetary gifts made by a corporate taxpayer. Revenues shall not include equity raised by a corporate taxpayer or debt repaid to it;

(7) 'entity' means any legal person or legal arrangement that carries on business through either a company or a structure that is transparent for tax purposes;

(8) 'tax period' means a corporate tax year, calendar year or any other applicable period for corporate tax purposes;

(9) 'associated enterprise' means an entity that is related to the particular entity in question in one or more of the following ways:

(a) one of them participates in the management of the other by being in a position to exercise a significant influence over the other;

(b) one of them participates in the control of the other through a holding, directly or indirectly, in the other that exceeds 20% of the voting rights;

(c) one of them participates in the capital of the other through a right of ownership, directly or indirectly, in the other that exceeds 20% of the capital.

If more than one entity participates in the management, control or capital of the same entity in one or more of the ways specified in points (a) to (c), all of those entities shall be regarded as associated enterprises of each other too.

If the same entity participates in the management, control or capital of more than one entity in one or more of the ways specified in points (a) to (c), all of those entities shall be regarded as associated enterprises of each other too.

In case of indirect participations, fulfilment of the criteria set out in points (b) and (c) shall be determined by multiplying the percentages rates of holding through the successive tiers. An entity holding more than 50% of the voting rights shall be deemed to hold 100%.

CHAPTER II

SIGNIFICANT DIGITAL PRESENCE

Article 4

Significant digital presence

1. For the purposes of corporate tax, a permanent establishment shall be taken to exist if a significant digital presence exists through which a business is wholly or partly carried on.

2. Paragraph 1 shall be in addition to, and shall not affect or limit the application of, any other test under Union or national law for determining the existence of a permanent establishment in a Member State for the purposes of corporate tax, whether specifically in relation to the supply of digital services or otherwise.

3. 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:
(a) 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;
(b) 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;
(c) 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.

4. With respect to using digital services, a user shall be deemed to be located in a Member State in a tax period if the user uses a device in that Member State in that tax period to access the digital interface through which the digital services are supplied.

5. With respect to concluding contracts for the supply of digital services:
(a) a contract shall count as a business contract if the user concludes the contract in the course of carrying on business;
(b) a user shall be deemed to be located in a Member State in a tax period if the user is resident for corporate tax purposes in that Member State in that tax period or the user is

resident for corporate tax purposes in a third country but has a permanent establishment in that Member State in that tax period.

6. The Member State where a user's device is used shall be determined by reference to the Internet Protocol (IP) address of the device or, if more accurately, any other method of geolocation.

7. The proportion of total revenues referred to in paragraph 3(a) shall be determined in proportion to the number of times that devices are used in that tax period by users located anywhere in the world to access the digital interface through which the digital services are supplied.

Article 5

Profits attributable to or in respect of the significant digital presence

1. The profits that are attributable to or in respect of a significant digital presence in a Member State shall be taxable within the corporate tax framework of that Member State only.

2. The profits attributable to or in respect of the significant digital presence shall be those that the digital presence would have earned if it had been a separate and independent enterprise performing the same or similar activities under the same or similar conditions, in particular in its dealings with other parts of the enterprise, taking into account the functions performed, assets used and risks assumed, through a digital interface.

3. For the purposes of paragraph 2 the determination of profits attributable to or in respect of the significant digital presence shall be based on a functional analysis. In order to determine the functions of, and attribute the economic ownership of assets and risks to, the significant digital presence, the economically significant activities performed by such presence through a digital interface shall be taken into account. For this purpose, activities undertaken by the enterprise through a digital interface related to data or users shall be considered economically significant activities of the significant digital presence which attribute risks and the economic ownership of assets to such presence.

4. In determining the attributable profits under paragraph 2, due account shall be taken of the economically significant activities performed by the significant digital presence which are relevant to the development, enhancement, maintenance, protection and exploitation of the enterprise's intangible assets.

5. The economically significant activities performed by the significant digital presence through a digital interface include, inter alia, the following activities:

(a) the collection, storage, processing, analysis, deployment and sale of user-level data;

(b) the collection, storage, processing and display of user-generated content;

(c) the sale of online advertising space;

(d) the making available of third-party created content on a digital marketplace;

(e) the supply of any digital service not listed in points (a) to (d).

6. In determining the attributable profits under paragraphs 1 to 4, taxpayers shall use the profit split method unless the taxpayer proves that an alternative method based on internationally accepted principles is more appropriate having regard to the results of the functional analysis. The splitting factors may include expenses incurred for research, development and marketing as well as the number of users and data collected per Member State.

CHAPTER III
FINAL PROVISIONS

Article 6

Review

1. The Commission shall evaluate the implementation of this Directive five years after its entry into force and report to the Council thereon.

2. Member States shall communicate to the Commission all information necessary for evaluating the implementation of this Directive.

Article 7

Committee on the taxation of the digital economy

1. An advisory committee on the taxation of the digital economy, called the 'DigiTax Committee', is set up.

2. The DigiTax Committee shall consist of representatives of the Member States and of the Commission. The chair of the Committee shall be a representative of the Commission. Secretarial services for the Committee shall be provided by the Commission.

3. The DigiTax Committee shall adopt its own rules of procedure.

4. The DigiTax Committee shall examine questions on the application of this Directive, as raised by the chair of the Committee, whether on the chair's own initiative or at the request of the representative of a Member State, and shall inform the Commission of its conclusions.

Article 8

Limitation of data collected from users

The data that may be collected from the users for the purposes of applying this Directive shall be limited to data indicating the Member State in which the users are located, without allowing for identification of the user.

Article 9

Transposition

1. Member States shall adopt and publish, by 31 December 2019 at the latest, the laws, regulations and administrative provisions necessary to comply with this Directive. They shall immediately inform the Commission thereof.

They shall apply those provisions from 1 January 2020 with respect to tax periods beginning on or after that date.

When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

2. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

Article 10

Entry into force

This Directive shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

Article 11

Addressees

This Directive is addressed to the Member States.

Done at Brussels,

For the Council
The President