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COMMISSION RECOMMENDATION

of 21.3.2018

relating to the corporate taxation of a significant digital presence

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THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 292 thereof,

Whereas:

- (1) The Commission Communication on "A Fair and Efficient Tax System in the European Union for the Digital Single Market"¹ adopted on 21 September 2017 stated that new international rules specific to the challenges raised by digital economy are needed to determine where the value of businesses is created and how it should be attributed for tax purposes. To advance the approaches considered under the Organisation for Economic Co-operation and Development (OECD) / G20 Base Erosion and Profit Shifting (BEPS) Project Action 1 report on "Addressing the Tax Challenges of the Digital Economy"² released in October 2015 and further examined in the OECD "Tax Challenges Arising from Digitalisation – Interim Report 2018"³, this would entail reform of international tax rules on the concept of a permanent establishment, transfer pricing and profit attribution applicable to activities related to the supply of digital services.
- (2) 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. The ECOFIN Council in its 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 encouraged close cooperation between the Union, the OECD and other international partners in responding to the challenges of taxation of profits of the digital economy.
- (3) The ECOFIN Council in its same Conclusions also urged the OECD to find appropriate solutions for upgrading the global network of double tax conventions, modify its Model Tax Convention and accompanying commentaries, as well as its Transfer Pricing Guidelines and Guidance on Attribution of Profits to Permanent Establishments, in order to address these global challenges.
- (4) The permanent establishment concept as currently set out in Article 5 of the OECD Model Tax Convention should be revised to take into account criteria such as revenue

¹ COM(2017) 547 final.

² OECD (2015), Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264241046-en>

³ OECD (2018), Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264293083-en>

and other user-based criteria for determining the "significant digital presence" of a business. The profit attribution rules as currently set out in Articles 7 and 9 of the OECD Model Tax Convention and the OECD Transfer Pricing Guidelines should be revised to take into account, for example, the contribution of users and data to the creation of value. The international work should include further consideration of the use of the profit split method to ensure a fair allocation of profits to or in respect of the significant digital presence.

- (5) Double tax conventions play an important role in encouraging cross-border trade efficiency by improving certainty for taxpayers as regards their international dealings. By entering into a double tax convention, the contracting states agree to allocate taxing rights between themselves with a view to eliminating double taxation and thereby fostering economic activity and growth. Appropriate revisions and additions to the double tax conventions signed by Member States with their non-Union partners should therefore be promoted in order to ensure consistency between the Digital Single Market and the global economy.
- (6) Member States are invited to use as a source of illustration or interpretation for the changes to their double tax conventions with non-Union jurisdictions the provisions of the proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence (COM(2018) 147 final).

HAS ADOPTED THIS RECOMMENDATION:

1. General

This Recommendation puts forward a proposal for adaptations to the double tax conventions of Member States with non-Union jurisdictions in order, first, to extend the concept of a permanent establishment so as to include a significant digital presence through which the business of an enterprise is wholly or partly carried on in another jurisdiction, and, second, to include rules for attributing profits to or in respect of a significant digital presence.

2. Recommendation

Member States are recommended to negotiate the necessary adaptations to their double tax conventions with non-Union jurisdictions so as to bring into effect the following elements:

(a) a definition of a significant digital presence as follows:

'1. For the purposes of this Convention, the term "permanent establishment" shall also include a "significant digital presence" through which the business of an enterprise is wholly or partly carried on.

2. A "significant digital presence" shall be considered to exist in a jurisdiction in a tax period if the business carried on through an enterprise 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 enterprise carrying on that business, taken together with the supply of any such services through a digital interface by each of that enterprise'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 jurisdiction in that tax period exceeds EUR [...]*
- b) the number of users of one or more of those digital services who are located in that jurisdiction in that tax period exceeds [...]*

- 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 jurisdiction exceeds [...]*

* The thresholds for determining when a significant digital presence constitutes a permanent establishment should be defined in the double tax conventions in line with those set by the national rules of the Member States, taking into account the proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence (COM(2018) 147 final).

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

4. 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 jurisdiction in a tax period if the user is resident for corporate tax purposes in that jurisdiction in that tax period or has a permanent establishment in that jurisdiction in that tax period.

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

6. The proportion of total revenues referred to in paragraph 2(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.'

(b) rules for attributing profits to or in respect of a significant digital presence as follows:

'1. 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.

2. For the purposes of paragraph 1, 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 functions of the significant digital presence which attribute risks and the economic ownership of assets to such presence.

3. 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.

4. 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).

5. 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 jurisdiction.'

3. Interaction with other Union acts

It is recommended that provisions in the double tax conventions of Member States with non-Union jurisdictions take into account the definitions and other conditions for a significant digital presence and rules for attributing profits to or in respect of a significant digital presence laid down in the provisions of the proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence (COM(2018) 147 final) to ensure consistent application at the international level.

4. Follow-up

Member States should inform the Commission of the measures taken in order to comply with this Recommendation, as well as of any changes made to such measures.

5. Addressees

This Recommendation is addressed to Member States.

Done at Brussels, 21.3.2018

For the Commission

Member of the Commission

