REASONED OPINION
OF THE
HOUSE OF REPRESENTATIVES OF MALTA

Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence COM (2018) 147

and

Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services COM (2018) 148

1. Aim of the Commission Proposals

This proposal package 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 considers the features of the digital economy. This proposal lays down rules for establishing a taxable nexus for digital businesses operating across border in case of a non-physical commercial presence. New indicators for such a significant digital presence are required to establish and protect Member States' taxing rights in relation to the new digitalised business models. This proposal sets out principles for attributing profits to a digital business which rely on intangible assets.

2. Commission justification on compliance with the principle of subsidiarity

According to the first proposal's legal basis (Article 115 of the Treaty on the Functioning of the European Union), the Council acting unanimously and according to a special legislative procedure, and after consulting the European Parliament and the European Economic and Social Committee, shall issue directives for the *approximation* of such laws, regulations or administrative provisions of the Member States directly affecting the establishment or the functioning of the internal market. Despite the Commission's aims to eradicate distortions in the functioning of the internal market, the Commission also aims to rein in unilateral measures that have been, or are threatened to be, adopted by several Member States to address the same issues, which could create confusion and fragmentation with the European Single Market. It is already clear that not all Member States are aligned with the proposed measures. Given that European legislation relating to tax can generally be passed only with unanimous consent, the nature and timing of the successful enactment of this package remains uncertain.

The Commission's proposal rests on the principle that profits should be taxed where value is created, but with a significant twist: While the current rules largely allocate to a country, the right to tax the profits of a business on the basis of the physical presence that the business maintains within its borders — which must be significant enough to amount to a "permanent establishment" — the proposal would extend this test to include, with respect to the provision of digital services, the existence of a "significant digital presence." In substance, this means that where a non-resident business provides "digital services" through a "digital interface" to users "located" in a European Member State, and this business maintains a "significant digital

presence" in that Member State, the profits derived through this significant digital presence will be taxable in the Member State in question.

The second proposal's legal basis falls under Article 113 of the TFEU. This provision enables the Council, acting unanimously in accordance with special legislative procedure and after consulting the European Parliament and the EESC to adopt provisions for the harmonisation of Member States' legislation concerning other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and functioning of the internal market and to avoid distortion of competition.

3. Evaluation on the compliance of the principle of subsidiarity

The House of Representatives of Malta notes that the principles of subsidiarity and proportionality become relevant where the Union and the Member States share competence in a sector in terms of the Treaty on European Union and the Treaty on the Functioning of the European Union.

The House of Representatives of Malta retains that the proposed system of a Digital Services Tax **infringes the principle of subsidiarity** for the following reasons:

1. The aim of the Proposal can be better achieved through long-term national solutions coordinated at an international level rather than through the proposed European short-term measures. It is believed that the suggested *interim* measures impinge on established fundamental tax concepts and create more issues than solutions.

    a. The legal basis of the Proposal, which seeks to approximate laws in relation to corporate taxation is questionable given that the treatment proposed will distinguish between entities established in EU Member States and entities established in third countries which do not have a double taxation agreement with an EU Member State, and entities established in third countries which have double taxation treaties with an EU Member State in force. The unavoidable result of such approach is that of a difference in treatment afforded between Member States and third countries and Member States themselves given that Member States have different treaty networks with third countries.
    b. The Proposal impinges on fundamental tax concepts, such as that of the permanent establishment, which is a key concept in the OECD Model Tax Convention on Income and on Capital, which remains the most authoritative source used by countries when negotiating conventions with each other.

2. The House of Representatives holds that the research and reports provided by the OECD are merely guidelines provided for an international approach, however, the Commission in this proposal goes beyond its scope and has thus decided to take action. This however would imply impinging on the Member States' tax competence and prove that there are no strong arguments in terms of subsidiarity.

    The Impact Assessment fails to meet the requirements of the principle of subsidiarity for the following reasons:

a. The Commission declares that the Proposal aims to steer discussions at international level for long-term reform. Whilst one could understand the political motivations of such an approach, it is believed that such aspects ought to be subservient to evidence based policy action. Moreover, the Commission states that this policy framework will be mirroring the changes in the OECD Model Tax Convention at international level, thereby rendering the current proposed measures redundant.
b. Illustrations of possible unilateral action by Member States as a justification for taking legislative action appear pertinent for the Digital Service Tax initiative, but seem to have little relevance for this initiative. This is more so when considering that the changes to the permanent establishment provisions are clearly part of the international tax framework and require international uptake for their effectiveness, and the fact that OECD Base erosion and profit shifting (BEPS) Inclusive Framework already aims towards a consensus based solution by 2020.
c. The BEPS arguments are not constant throughout the Impact Assessment and although used to justify the need for a Directive, it is also recognised that changes to the permanent establishment provision (and profit attribution rules) is a fundamental change to the existing international rules which go beyond anti-BEPS measures. In this regard, whilst the baseline scenario of the Impact Assessment assumes Anti-Tax Avoidance Directive's transposition, the proposed text hardly elaborates why the application of these rules (within the EU via ATADs, but also within third countries which are still coming on stream) would not be pertinent developments to monitor before proposing this Union action. It is pertinent to note that as highlighted in the OECD's interim report, there is already "preliminary evidence that implementation of the BEPS package more generally is having an impact".
d. It disregards any consideration on the consequential impacts that the extended permanent establishment would have on other distributive rules typically found within Member States' double taxation treaties.
e. The approach taken within the Proposal does not take cognisance of the needs of smaller markets.

The Maltese House of Representatives recognises that there is a common interest in maintaining a coherent yet relevant set of international tax rules in view of the digitalisation of the economy, and it is ready to engage in the discussions which will ensue on the Commission proposals. However, the Maltese House of Representatives has a clear preference to go for solutions at the international level which are globally applicable. For this reason, the House of Representatives supports working towards a consensus-based solution in the OECD BEPS Inclusive Framework.

Furthermore, given the global aspect of the digital economy, it is important to avoid duplication of work with the OECD and solutions in this area should ideally be found on a broader scale and if solutions are found, these should serve as input into broader OECD discussions. It must be stressed that unilateral EU measures may damage EU companies, thus it must be kept in mind that a risk of damaging competitiveness of EU companies may also be present.

4. Recommendation

For the reasons outlined above, the House of Representatives of Malta holds that less intrusive choices can lead to the achievement of the objectives behind the common system of a mechanism, both in the short term as well as in the long term, without interfering with the principles of subsidiarity and proportionality. The House of Representatives thus believes that the:

- **Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence (COM (2018)147); and the**
- **Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services (COM (2018) 148),**

do not satisfy the subsidiarity principle.

The House of Representatives of Malta has decided to object to the Proposals and to deliver this reasoned opinion in terms of the procedure defined in Article 6 of Protocol No. 2 concerning the Application of the Principles of Subsidiarity and Proportionality, annexed to the Treaty on the European Union and to the Treaty on the Functioning of the European Union.

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