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European Commission

INCEPTION IMPACT ASSESSMENT

Inception Impact Assessments aim to inform citizens and stakeholders about the Commission's plans in order to allow them to provide feedback on the intended initiative and to participate effectively in future consultation activities. Citizens and stakeholders are in particular invited to provide views on the Commission's understanding of the problem and possible solutions and to make available any relevant information that they may have, including on possible impacts of the different options.

TITLE OF THE INITIATIVE	*Digital Levy*
LEAD DG (RESPONSIBLE UNIT)	DG TAXUD Unit D4
LIKELY TYPE OF INITIATIVE	*Legislative proposal*
INDICATIVE PLANNING	*Q2 2021*
ADDITIONAL INFORMATION	–

The Inception Impact Assessment is provided for information purposes only. It does not prejudge the final decision of the Commission on whether this initiative will be pursued or on its final content. All elements of the initiative described by the Inception impact assessment, including its timing, are subject to change.

A. Context, Problem definition and Subsidiarity Check

Context

The European Commission has set out strategic objectives on how to shape Europe's digital future and to help ensure that Europe is fit for the Digital Age. Technological advancements and digitalisation are profoundly changing the way we work, do business, how people travel, communicate and relate. These changes give rise to innovation, growth, and new business models, but also important challenges. The COVID crisis has been a catalyst and accelerator of change, hastening the transition towards a more digital world and triggering important changes in behaviour that could have lasting effects.

Against this backdrop, the EU needs a modern, stable regulatory and tax framework to appropriately address the developments and challenges of the digital economy. Recently, the Commission adopted the Digital Services Act package, which aims at better protecting consumers and their fundamental rights online, and at promoting fairer and more open digital markets for everyone. This new proposal covers digital services, including social media, online market places, and other online platforms that operate in the European Union. While digitalisation can increase productivity and consumer welfare, and should thus be fostered and nurtured, it is also of paramount importance to ensure that digital companies contribute their fair share to society, since a prolonged unequal distribution of rights and responsibilities undermines the social contract.

Work is ongoing at the G20 and OECD level to find a global solution that can support a reform of the international corporate tax framework in order to address some of the challenges related to the digitalisation of the economy. A number of elements remain to be agreed, but parameters indicate that the OECD agreement will focus on large, multinational enterprise groups and a limited number of pre-defined activities linked to digitalisation, possibly in a first step. In the absence of a global agreement, some Member States have in the meantime introduced certain temporary tax measures affecting businesses that are part of the digital economy.

In its conclusions of 21 July 2020, and in view of a need to support the EU's borrowing and repayment capacity, the European Council tasked the Commission with putting forward proposals for additional own resources. The digital levy is one of them. The new initiative will help address the issue of fair taxation related to the digitalisation of the economy and, at the same time, is intended to not interfere with the ongoing work at the G20 and OECD level on a reform of the international corporate tax framework.

Problem the initiative aims to tackle

Digitalisation of the global economy is progressing fast and brings many benefits. At the same time, an important characteristic of digital businesses is their ability to operate in certain jurisdictions and earn revenues elsewhere. Digital businesses rely heavily on intangible assets. They are also able to generate large revenues by making particular use of and by monetising consumer and user data and user-created content. Much of this value created by users is not captured by the current tax systems. Furthermore, the place of value creation might not be aligned with the place of taxation. Taxes are thus often paid, if at all, in locations different from where the value is created.

Digital businesses can indeed benefit from *scale without mass* and do not necessarily pay corporate taxes in all jurisdictions where they have a significant economic presence. Moreover, digital business models rely heavily on intangible assets, allowing digital companies to shift profits to certain jurisdictions more easily and thus pay less tax compared to more traditional businesses. In addition, automated digital services can provide services at close to zero marginal costs and often exploit powerful user network effects. These factors create a strong tendency towards market concentration and the accumulation of market power and lead to digital companies exploiting and possibly worsening market inefficiencies. As such, the ineffective taxation of companies engaging in the digital economy and the digital sector's speedy growth, impact the level playing field between these companies and those of other sectors of the economy.

Lower taxes, or even no taxes at all, paid by companies engaged in the digital economy weaken the sustainability of public finances. This is particularly blatant at a moment when the EU and Member States are facing a greater fiscal and debt burden as they tackle the COVID-19 crisis and support a recovery. The EU and Member States will need to avail themselves of all major instruments to ensure a sustainable and fair recovery, and that stable future revenues are secured in a manner well aligned with the significant economic changes to come.

Basis for EU intervention (legal basis and subsidiarity check)

A fair and competitive digital economy is one of three strategic priority areas in the agenda on *Shaping Europe's Digital Future*[1]. This means ensuring that EU rules, including in the area of taxation, are fit for purpose in the digital economy, and that companies compete in Europe on fair terms.

The new initiative can mitigate distortions and the risk of fragmentation of the EU single market resulting from the uneven playing field between operators in the digital sphere as well as the digital sector and other sectors of the economy. Action at the EU level would help reduce these risks and strengthen the single market for digital activities, in line with the Digital Services Act package. Furthermore, the problems of the current tax framework to address the reality of companies operating in the digital sector are not particular to a specific Member State, but constitute a common challenge for the EU as a whole. Coordinated action at EU level is necessary to address these challenges in an efficient and comprehensive manner and preserve the functioning of the internal market.

The legal basis will depend on the final design of the initiative. Both Article 113 (harmonisation of indirect tax rules to ensure the functioning of the internal market) and Article 115 (harmonisation of other tax rules to ensure the functioning of the internal market) of the Treaty on the Functioning of the European Union (TFEU) are relevant, either separately or combined.

B. Objectives and Policy options

The main objective of the initiative is to come forward with a measure that allows for a fairer contribution from the companies that operate in the digital sphere for the purposes of the recovery and to support a more stable medium-term outlook. Modernising tax rules to better fit current circumstances and the expected increase in digitalisation should allow that the initiative better fits the reality of the digital economy and addresses future developments head on, limiting the risk of short-term solutions and distortions across businesses of different types and origins.

The initiative will be designed in a way that is consistent with the Digital Services Act package and the Commission's digital strategy to ensuring a fair and competitive digital economy, as announced in the Communication 'Shaping Europe's digital future'.

The work undertaken in the OECD Inclusive Framework to find a global consensus-based solution that addresses the tax challenges of the digitalisation of the economy is considered and should be factored into the final design and scope of the initiative, as it is important not to undermine the ongoing discussions at the OECD nor to fuel international trade tensions. The initiative should be designed in a way that is compatible with the international agreement to be reached in the OECD as well as broader international obligations.

The baseline scenario will take account of developments at international level. The Commission will identify additional policy options, such as:

- A corporate income tax top-up to be applied to all companies conducting certain digital activities in the EU
- A tax on revenues created by certain digital activities conducted in the EU
- A tax on digital transactions conducted business-to-business in the EU

The Commission will have to develop the policy options, and design the central scenario, on the basis of several building blocks:

[1] https://ec.europa.eu/info/sites/info/files/communication-shaping-europes-digital-future-feb2020_en_4.pdf

- Scope and definition of digital activities/transactions or companies subject to the initiative: This is a vital part of the work to be carried out, considering the different business models of companies present in the digital economy.
- The relationship with the EU's and Member States' international obligations, including interaction with Double Taxation Conventions. Notably, the initiative must also comply with the rules of the World Trade Organisation.
- Fairness considerations: The design of the initiative will have to take into account the possible impact on small and medium sized enterprises (SMEs), digital companies with a dominant vs. weak market position, or consumers of digital content or goods.
- Potential behavioural reactions: It will be important to design the initiative in such a way as to mitigate incentives to avoid payment of the new tax/levy that will be established.
- Forward-looking design: The design of the measure should take into consideration the future evolvement of the digital economy with a view to putting into place a sustainable tax framework and providing tax certainty for businesses.

C. Preliminary Assessment of Expected Impacts

Likely economic impacts

The impact will vary depending on the design of the initiative and, in particular, on the scope and definition of digital activities to be subject to the initiative and on who will ultimately bear its burden. The initiative is likely to have an impact on the following dimensions, which will have to be analysed to the extent possible:

- Businesses engaging and operating in the digital economy, including the impact on foreign businesses operating in the EU;
- Competitiveness and GDP, as the initiative is likely to affect investment decisions and productivity, but also is intended to create a more level-playing field among digital companies;
- Tax compliance costs, which will depend on the option and design parameters chosen;
- Tax revenues, including in view of the interaction with other tax categories;
- Consumers.
- The potential impact on digitalisation, which remains a policy priority for the European Union, and trade relations should also be taken into consideration as far as possible.

Likely social impacts

The initiative aims to make digital companies pay their fair contribution, and will therefore support revenue generation and help the sustainability of Member States' public finances, as well as affect positively the (perceived) social fairness of the tax system.

Likely environmental impacts

No direct environmental impact is expected.

Likely impacts on fundamental rights

There is no impact expected on fundamental rights. The potential implications of the initiative on personal data and the way they are treated by digital companies are likely to be negligible.

Likely impacts on simplification and/or administrative burden

In principle, all digital businesses could be affected by the additional compliance burden, although special attention will be paid in the design of the options to prevent that SMEs are disproportionately impacted. National tax administrations could face additional administrative obligations in relation to implementing the new system, in particular because of enforcement and collection requirements.

The analysis that will underpin the initiative will seek to identify and mitigate to the maximum extent possible the expected regulatory, administrative and compliance costs associated with the delivery and implementation of the initiative.

D. Evidence Base, Data collection and Better Regulation Instruments

Impact assessment

An impact assessment will be carried out to support the preparation of this initiative and to inform the Commission's decision on establishing the appropriate design parameters. Both economic models and appropriate quantitative tools will be used in order to assess the potential economic and tax revenue effects of the initiative as well as the impact of the proposed options on businesses and on households.

These interactions should be considered since the initiative would not apply to a sector isolated from the rest of the economy nor in a tax-free world. Two features will be worth considering in this respect: i) the possibility for an economic model to take into account the existing corporate tax system and potential fiscal interactions; and (ii) the close connection between the digital sector and the rest of the economy.

Evidence base and data collection

Data and information is required for the assessments and analyses underpinning this initiative. Eurostat data on the digital economy as well as other relevant datasets (e.g., Eurostat, Orbis, CAPITAL IQ, OECD) will be used. The analysis will also rely on data and analytical work built with expertise and support from the Joint Research Centre. Moreover, relevant studies from the OECD, IMF, UNCTAD and other similar sources on the digital sector and taxation of the digital economy will also be a valuable source of information.

Consultation of citizens and stakeholders

The aim of the public consultation will be to allow all stakeholders to give their views on all the aspects of a digital levy, as well as on the potential impact of the different options under consideration. The consultation will be based on a questionnaire. It will run for a period of 12 weeks and will be accessible via the Commission's Better Regulation Portal (https://ec.europa.eu/info/consultations_en).

The main expected stakeholder groups to be consulted through the public consultation are:

- Member States / public authorities
- Business associations (digital services, e-commerce, SMEs, others)
- Non-governmental / civil society organisations
- Citizens (individuals)
- Academia

In addition to the general public consultation, a limited number of more targeted consultation actions could take place (e.g., with the European Parliament, the European Economic and Social Committee, or with relevant stakeholders).

Will an Implementation plan be established?

An implementation plan will be prepared together with the legislative proposal.