EU takes criticism for digital tax plans and state aid aggression

IFA's panel on EU developments were critical of its digital taxation package and state aid aggression

The EU update seminar at the IFA annual congress dealt with a lengthy menu of court decisions and important initiatives, including the first transfer pricing litigation to reach the European Court of Justice, the unveiling of the European Commission's digital taxation package and the use of state aid to attack alleged transfer pricing abuses.

Juliane Kokott, an advocate general of the Court of Justice of the European Union (CJEU), discussed the *Hornbach-Baumarkt* case, which centred on a German tax office ruling that the comfort letters Hornbach, a German company, had provided for its Dutch subsidiaries were not at arm's length. It adjusted the company's tax bill upwards, but Hornbach objected, saying that this was a breach of freedom of establishment because the tax office did not do this for domestic transactions. The CJEU ruled that taxpayers should have the opportunity to show why they may not have stuck to the arm's-length principle in their transfer pricing.

State aid and transfer pricing

The panel also tackled the European Commission's use of state aid principles to attack tax avoidance, such as in the actions it has taken against Ireland (Apple), Netherlands (Starbucks) and Luxembourg (Fiat). Kokott pointed out that, as yet, no case on state aid had got as far as the General Court of the European Union or the Court of First Instance. "It is new territory for the European courts," she said.

"Sune Hein Bertelsen, who chairs the panel of tax directors of large business at the Confederation Danish Industry, said taxpayers should not be punished if their transfer pricing fell within the boundaries of the OECD's Transfer Pricing Guidelines. He also thought it was unfair that it was companies that had to repay any illegal state aid going back for 10 years and was worried that multinationals might prefer to invest in locations other than the EU because they did not use state aid rules as aggressively.

"It's the law of big targets," said Phil West, chairman of Steptoe, a US law firm, referring to the identity of the companies concerned. "The appearance that it is going on is sufficient enough for us to pause."

Digital tax proposals lacking

The IFA polling technology had failed a number of the panels earlier in the week, but Pasquale Pistone, the chairman of the seminar, felt confident enough to give it a go on the subject of the taxation of new business models and whether international organization was addressing it in the right way.

In two votes, delegates rejected existing approaches to the taxation of digitalized companies, though perhaps not as resoundingly as one might have expected beforehand.

While almost 70% believed that international tax rules were not capable of dealing with the increasing digitalization of the economy, that meant about 30% did and though about 72% felt the EU should not press ahead with its proposals for the taxation of digital technology companies, before the OECD reached a consensus about what to do, it left roughly 28% who want the EU to proceed with a package that includes the so-called digital services tax (DST), a 3% charge on revenues from online advertising, sales of data collected from users and digital platforms that facilitate interaction between users, and the idea of a Significant Digital Presence, a concept that would be taxed in each member state, according to a company's revenues from digital services, number of users and number of online business contracts.

"Business does not see much more than shortcomings from the DST," said Bertelsen. He listed a number of its faults including that it was a temporary tax that risked becoming permanent, that it was a 'fundamental deviation' from corporate tax principles of profit or turnover and that it corresponded to a 20% tax rate on profits for businesses that make 15% of their turnover in profits

"The sign of a good tax is that it avoids double taxation," said West, "so the creditability of the DST comes into play in the US. It won't qualify as an income tax, so would have to be accepted as in lieu of a normal income tax in the foreign country and it is not easy to get the IRS to accept something as in lieu of tax." For a tax to be creditable as in lieu of tax it has to substitute an income tax. "But the DST is only temporary, so will be replaced as soon as the EU can agree on a definition of digital presence, not the other way round. It's difficult to see that as creditable in the US," added West.

West tried to dissuade anyone from arguing that the US Supreme Court's decision in *Wayfair* was a good model for taxing digital technology companies: "You should remember that that case was about a consumption tax, not an income tax. If we want to have a discussion about consumption tax, then let's do that, but that's not what the DST is."

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Article published on International Tax Review, 10 September 2018