



# What's behind Italian Budget Law 2020: the Italian Digital Service Tax



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TAX, PERSPECTIVES, SOCIETY

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## Abstract

**T**axation of digitalized business and economy is facing a pivotal moment. The starting point is the consensus that the taxation should take place where value is created but currently there is a mismatch between where taxation of the profit takes place and where value is created for certain digital services.

How to better address the serious tax challenges it poses to global tax system is currently at the top of worldwide debate among stakeholders.

At the centre of the debate is whether international income tax rules, developed in a “brick-and-mortar” economic environment well more than a century

ago, remain appropriate for purpose in the modern global economy which facilitated by digitalisation – scale without mass, reliance on intangible assets, and the centrality of data.

In this context of uncertainties, the French and the Italian governments took the position to implement unilateral measures aimed at tackling digital multinationals harmful practice and taxing revenues from qualified “digital services” implying intensive users’ involvement in value.

In this framework, among other measures, the 2020 Italian Budget Law<sup>1</sup> (re)introduced a 3% Digital Service Tax on the revenues from qualified digital

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<sup>1</sup> See Art. 1 (para 678) Law December 27, 2019, no. 160.

services (ISDT) substantially mirroring the EU Proposal of Directive COM148/2018. Under the ISDT, taxable revenues sourced by business entities providing relevant digital services marketed in Italy are covered.

IDST came into force 1st January 2020 but will be repealed once an agreement on the taxation of the digital services at the international level is reached.

### **The pitfall and the rise of the Italian Digital Service Tax**

The implementation of an Italian Digital Service Tax has not been an easy affair for the Italian government.

Italian policy makers attempted forth times to succeed – lastly with the 2018 Italian Budget Law<sup>2</sup> and with the 2019 Italian Budget Law<sup>3</sup> - but IDST provisions never entered into force due a lack of compulsory enforcement decrees.

Yet, recently the Budget Law 2020 reshaped the IDST set forth by the Budget Law 2019 to come into force as from 1st January 2020 without compulsory enforcement decree. However, due to a so-called “sunset clause”, it would be repealed until, and unless, common consensus on corporate taxation principles towards digitalized business and economy is achieved at international level.

### **Background of the Italian DST**

International tax policy makers are still struggling to find a common consensus on solutions which can ensure a fair and effective taxation as the digital

transformation of the economy accelerates mainly because existing corporate tax principles are outdated and do not capture this evolution.

Common tax principles no longer fit the present context where:

- online trading across borders with no physical presence has been facilitated;
- businesses largely rely on hard-to-value intangible assets;
- user generated contents and data collection have become core activities for the value creation of digital businesses.

This framework originated high level of political commitment both at International and EU levels.

At International level, the OECD recognized (Action 1, BEPS project<sup>4</sup>) that digitalization and some of the resulting business models give rise to challenges as to commonly agreed international taxation principles. Accordingly, OECD designed solutions impacting on fundamental rules of the International income tax system and proposed public consultations underlying revised principles on Profit allocation rule - based on the arm's length principle - and Nexus rules - based on physical presence (Pillar 1)<sup>5</sup>, as well as on Global Anti-Base Erosion Proposal (Pillar 2)<sup>6</sup>.

At EU level, two substantial proposal of Directives were released in the context of the Digital Single Market strategy<sup>7</sup> mirroring the OECD works:

- Proposal of Directive COM147/2018: A common reform of the EU's corporate tax rules for digital activities - Long-term solution (*The Virtual*

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<sup>2</sup> See art. 1 (para 1011) Law December 27, 2017, no. 205.

<sup>3</sup> See Art. 1 (para 35) Law December 30, 2018, no. 145.

<sup>4</sup> See BEPS Action 1: *Address the Tax Challenges of the Digital Economy*, March 24 2014 and Tax Challenges Arising from Digitalisation – Interim Report 2018, Inclusive Framework on BEPS, Published on March 16, 2018.

<sup>5</sup> See <https://www.oecd.org/tax/beps/oecd-secretariat-invites-public-input-on-the-global-anti-base-erosion-proposal-pillar-two.htm>

<sup>6</sup> See <https://www.oecd.org/tax/beps/oecd-secretariat-invites-public-input-on-the-global-anti-base-erosion-proposal-pillar-two.htm>

<sup>7</sup> COM(2017) 547 final (<https://eur-lex.europa.eu/legal-content/IT/TXT/PDF/?uri=CELEX:52017DC0547&qid=1508416540053&from=IT>)

*Permanent Establishment*). This proposal would enable Member States to tax profits that are generated in their territory, even if a company does not have a physical presence there. The new rules would ensure that online businesses contribute to public finances at the same level as traditional 'brick-and-mortar' companies. The new rules will also change how profits are allocated to Member States in a way which better reflects how companies can create value online: for example, depending on where the user is based at the time of consumption. Ultimately, the new system secures a real link between where digital profits are made and where they are taxed. The measure could eventually be integrated into the scope of the Common Consolidated Corporate Tax Base (CCCTB) – the Commission's already proposed initiative for allocating profits of large multinational groups in a way which better reflects where the value is created.

- Proposal of Directive COM148/2018: An interim tax on certain revenue from digital activities (*The Digital Tax*). The interim tax ensures that those activities which are currently not effectively taxed would begin to generate immediate revenues for Member States. It would also help to avoid unilateral measures to tax digital activities in certain Member States which could lead to a patchwork of national responses which would be damaging for a Single Market. Unlike the common EU reform of the underlying tax rules, this indirect tax would apply to revenues created from certain digital activities which escape the current tax framework entirely. This system will apply only as an interim measure, until the comprehensive reform has been implemented and has inbuilt mechanisms to alleviate the possibility of double taxation. The tax will apply to revenues created from activities where users play a major role in value creation and which are the hardest to capture with current tax rules, such as those revenues:

- created from selling online advertising space
- created from digital intermediary activities which allow users to interact with other users and which can facilitate the sale of goods and services between them
- created from the sale of data generated from user-provided information

Tax revenues would be collected by the Member States where the users are located and will only apply to companies with total annual worldwide revenues of €750 million and EU revenues of €50 million. This will help to ensure that smaller start-ups and scale-up businesses remain unburdened. An estimated €5 billion in revenues a year could be generated for Member States if the tax is applied at a rate of 3%.

Against this background the Italian government substantially modeled the IDST on the Proposal of Directive COM148/2018.

## Key Features of the IDST

### *Taxable Persons*

IDST will be levied on revenues from **qualified digital services** generated by **business entities** (standalone or as group) which meet the following thresholds in a year:

- Worldwide revenues equal at least Euro 750 million, and
- Revenues from qualifying digital services marketed in Italy equal at least Euro 5.5 million.

Thresholds are calculated taking into account revenues generated in each fiscal year preceding the one in which IDST is due (i.e., for FY 2020 revenue thresholds are assessed based on revenues generated in FY 2019).

IDST is due by taxable persons irrespective the nature of the service (B2C and B2B) however, revenues from intergroup transactions fall outside its scope.



Taxpayers resident for tax purposes in non-EU/EES States - that have not concluded with Italy an agreement for the mutual assistance against tax evasion/fraud and for the recovery of tax credit claims - should appoint an Italian tax representative for the IDST compliance.

#### *Qualified Digital Services*

IDST is a tax with a targeted scope, levied on the revenues from the supply of digital services characterized by a high degree of Italian user involvement in value creation. Particularly, under IDST taxable revenues are those derived from the provision of any of the following services:

- a) services consisting in the placing on a digital interface of advertising targeted at users of that interface (i.e. **digital advertising** e.g. Facebook, Google, AdWords, Twitter, Instagram, “free” Spotify);
- b) services consisting in the making available of multi-sided digital interfaces to users which allow users to find other users and to interact with them, and which may also facilitate the provision of underlying supplies of goods or services directly between users (i.e. **intermediation services** e.g., Airbnb, Uber);
- c) services consisting in the **transmission of data** collected about users which has been generated from such users' activities on digital interfaces.

To the contrary, revenues derived from the provision of the services summarized herebelow are out of the scope of the IDST:

- direct sale of goods or services in the context of an intermediation service (e.g., Ebay),
- supply of goods and services which are contracted online via the website of the supplier of such goods or services who does not perform intermediary functions (e.g., e-commerce),
- making available of a digital interface where the sole or main purpose is to supply digital content to users or to

supply communication services to users or to supply payment services to users (e.g., Netflix, Paypal, WhatsApp),

- making available of a digital interface the supply of a series of financial services (including crowdfunding) and transmission/sale of data.

#### *Place of taxation (The new nexus)*

In line with the concept of user value creation, services are relevant for IDST purposes if **marketed to users located in Italy**.

Under IDST users are deemed to be located in Italy essentially if their devices are used in Italy. To this end, user's device is considered as such mainly by reference to the **Internet Protocol (IP)** address of the device or, if more accurate, any other method of geolocation, in compliance with the rules on protection and treatment of personal data.

#### *Taxable Base (Relevant revenues) and rate*

IDST taxable base is calculated on **gross revenues** (i.e., including business-related expenses and VAT) from the provision of relevant digital services linked to the Italian territory.

For each tax period, taxable persons shall calculate (a) the overall worldwide taxable revenues from the provision of digital services (to any user wherever located) and (b) the share of qualified revenues relevant in Italy which would be subject to IDST.

The share of revenues is defined depending on each of the three relevant services covered by IDST – the number of times an advertisement appeared on users' devices located in Italy in the relevant tax period (for digital advertising), the number of users having used their account or concluded underlying transactions on the digital interface in Italy in that tax period (intermediation services), the number of users who have used a device located in Italy to access the digital interface in the relevant tax period and from whom data



transmitted has been generated (data transmission).

The IDST would apply at **3% rate** on the share of revenues so calculated. IDST could be deducted from taxable base of Italian corporate income tax.

Entities subject to IDST should prepare **periodical accounting reports** of revenues from digital services giving evidence of the criteria used for the allocation of revenues to Italy.

An **annual IDST return** should be filed within 31 March of the calendar year following the one which the IDST refers.

IDST should be paid within 16 February of that same fiscal year i.e., for 2020, IDST should be paid within 16 February 2021 and returns should be filed within 31 March 2021.

Multinational group companies are entitled to elect a company for said IDST accomplishments.







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