Italy turns up the heat on EU with digital sales tax

Italy is hoping its proposed digital sales tax will send a message to the EU and accelerate the process of finding consensus on digital economy taxation. However, the proposal interferes with the EU's plans and could create double taxation scenarios.

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Italy hopes to curb tax avoidance by digital companies with a proposal for a new digital sales tax that, if approved, would apply from January 1 2019. The proposal would impose a 6% tax on digital transactions made through electronic means to Italian tax residents with business income, and to Italian permanent establishments (PE) of non-tax residents. This will work out as the buyer paying the service provider 94% of the amount, while withholding 6% for the Italian Treasury.

The tax will apply to all relevant service providers irrespective of place of residence or place of transaction, but individuals without business income are exempt. A comprehensive list of which services qualify as digital services will be issued before April 2018.

The Italian Senate's budget committee approved the draft as an amendment to the 2018 budget on November 26, and is now pending approval by the Chamber of Deputies.

However, the proposal seems to have created more questions than solutions.

The initiative is a unilateral measure, taken in advance of coordinated EU action, said Piergiorgio Valente, managing partner at Valente Associati GEB Partners and participant in the European Commission's Platform for Tax Good Governance and Anna Manitara, adviser at the same firm. "Although it reflects concepts under discussion at EU level and internationally, it precedes any EU decision on the matter. Hence it cannot be considered fit with EU efforts," they told *TP Week*.

In September 2017, Italy backed an initial proposal on a digital sales tax from France, together with countries such as Spain and Germany. The French President Emmanuel Macron set out the proposal,

which was dubbed the **equalisation tax** , but Italy looks set to be the first country to actually implement such a tax.

Valente and Manitara pointed to the European Commission's position paper on the taxation of the digital economy from late September, which recognised the need for reform. The paper stressed that reaching consent at EU level should be a priority and stated that consensus was vital for success. However, Italy seems to think discussions are moving too slowly, and wants to accelerate the process by implementing its own digital sales tax.

Alfredo Fossati and Paolo Ruggiero, senior and junior partners at Fantozzi & Associati, said the impression is that the Italian Parliament wants to give a political signal to the EU community as already done, for example, on the financial transactions tax implemented in 2012. "Although the discussions on these issues and the implementation of BEPS rules could be positive, the introduction of a tax on such matters by one single state, not coordinated with the other states, can even create more problems than real solutions to the tax issues of web companies," they told *TP Week*.

Double taxation issues

Italy will need to look at its **tax treaty network** and find solutions to potential double taxation if the digital sales tax is implemented.

Gazzo and Zona said two critical aspects need to be addressed under Italy's tax treaty network: the actual applicability of the tax to treaty partners, and the creditability of the tax suffered in Italy against any tax covered by the treaty.

For non-resident companies that do not have a PE in Italy, the tax will be applied through a financial intermediary operating as a withholding agent.

"The digital tax being an income tax clearly cannot be applied to foreign companies in the absence of a PE in Italy. Applying the digital tax is a clear overriding of the double taxation treaties. From a technical point of view the withholding agent is the financial intermediary that intervenes into the transaction that will be tax liable for it. This is a crucial point," Fossati and Ruggiero said.

Gazzo and Zona said a web tax applied through a withholding tax by financial intermediaries could fail in tracing and taxing all transactions connected to advertising on websites that generate huge digital revenues.

"In light of this we believe that greater efforts should be made to introduce a tax which is line with the traditional international principles of taxation or to introduce new principles more adherent to the present and future dematerialised economy," they said. "What we do know is that a common international initiative – for example a common consolidated base tax at least within the EU – would really represent a value in this respect in order to avoid an unfair competition among the states."

Discouraging digital

There are also several other worries related to the tax.

Incompatibility with EU law, including fundamental freedoms, could become a problem, although the government has not yet disclosed enough details to analyse this. There is also a risk related to companies such as Google and Facebook, which likely would be subject to the tax, increasing prices to make up for the lost revenue, thereby passing the burden on to their customers.

It could also be seen as an attack on digital companies. Valente and Manitara said this risked discouraging digitalisation in Italy, which could have severe consequences for the national economy, and prejudice the potential increase of tax revenue in the long term.