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The Italian Web Tax from a National and International Perspective

To ensure taxation of digital business profits, Italy has introduced a web tax on digital transactions relating to a supply of services, sparking debate both domestically and internationally, since proposals are expected from the OECD and the European Union for coordinated solutions to the issue. This article provides an overview of questions that the Italian web tax has generated, concluding that Italy's actions have set off alarm bells that should promote prompt cooperation internationally.

1. Introduction

The year 2018 will be a key year with regard to international taxation of the digital economy. The OECD has promised to deliver concrete proposals by spring. The European Commission is also moving in the same direction, striving towards an even shorter term. Apparently, there is no time to wait. Digital business is evolving at the speed of light, penetrating all sectors of the market.[1] Digitalization of the economy is a widespread and ever-escalating fact; equally real is the income from the respective business activities. Yet, it is a well-known secret that such income is actually immune from states' taxing power due to the lack of appropriate taxing rules.[2] Hence, digital businesses seem to still enjoy their earnings almost in full, in contrast to the rest of the stakeholders.

In fact, specific states have decided not to wait for action at an international or supranational level and have resolved to unilaterally enact domestic provisions to tax income from digital businesses they consider sufficiently connected with their jurisdiction. Italy recently joined such states by introducing a "web tax", which has been highly debated internally and externally.[3] Other examples are the United Kingdom, India and Israel. In the United Kingdom, there are ongoing debates regarding the taxation of royalties involving sales in the United Kingdom, regardless of the residence of the licensor and licensee.[4] Similarly, as of 2016, India has been applying an equalization levy on income from certain services in relation to online advertising provided to residents or Indian permanent establishments (PEs).[5] Starting from the same year, Israel has been using the concept of significant economic presence to identify PEs.[6]

In principle, unilateral action, per se, has not been overly welcomed by the international community. However, under the present circumstances, it is not unjustifiable. In addition, it can act as an example of a useful experience with the application of specific taxes.

In view of the above, the purpose of this article is to analyse the newly introduced tax legislation in Italy from a national and international perspective.[7] In particular, the article is divided into five parts. Section 2. provides an overview of the provisions of the Italian law under examination. Section 3. refers to the specific measures for the taxation of the digital economy under consideration at an international and supranational level, i.e. by the OECD and the European Union. Section 4. includes some considerations arising from Italian law on web tax viewed from a national and international standpoint. Section 5. concludes that unilateral action – given its risks – should spur prompt and stronger cooperation in finding solutions.

2. Italian Web Tax Legislation

2.1. Introductory remarks

In recent years, Italy has been investing considerable resources in ensuring effective taxation of large web multinationals in its territory. Aggressive, systematic and comprehensive tax audits have been initiated, amongst others, against Apple, Google and Amazon; all three led to expensive settlement agreements with the Italian tax authorities.[8] In addition, advance pricing agreements were concluded or are under discussion for upcoming tax years. Moreover, in September 2017, in the context of a Eurogroup meeting, France, Germany, Italy and Spain argued openly in favour of gross taxation of income from digital activities in the European Union. Against such a back-

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1. European Commission, A Fair and Efficient Tax System in the European Union for the Digital Single Market, COM(2017)547 final (21 Sept. 2017), EU Law IBFD.
2. P. Valente, *Taxless Corporate Income: Balance against White Income, Grey Rules and Black Holes*, 57 Eur. Taxn. 7 (2017), Journals IBFD.
3. IT: Budget Law 2018, Law 205 (27 Dec. 2017) [hereinafter the "Budget Law"].
4. UK: HM Revenue & Customs, Royalties Withholding Tax, Consultation Document, available at: https://www.gov.uk/government/consultations/royalty-withholding-tax (accessed on 14 Mar. 2018).
5. IN: Finance Bill 2016, National Legislation IBFD.
6. IL: Circular 4/2016 of the Israeli Tax Authority.
7. Note that this article is based on information available at the time of writing, i.e. 14 Mar. 2018.
8. All three companies were charged with failing to declare taxes in Italy. The relevant audits led to identification of undeclared Italian PEs. Facebook is also under ongoing investigation by the Italian tax authorities.

drop, the new law came as no surprise to the Italian business market, as well as Italy's international partners.[9]

2.2. The web tax provisions

The web tax was introduced towards the end of 2017 by virtue of Budget Law 2018 and is to become effective as of 2019.[10] The Budget Law outlines the main features of the new tax, foreseeing the issuance of further implementing legislation to clarify certain aspects.

The web tax is to apply to digital transactions that have the following three features:[11]
– a supply of services via electronic means, namely the internet or other networks;
– involvement of Italian residents or Italian PEs of non-residents with business income (destination principle); and
– volume in excess of 3,000 transactions for a specific service provider/taxpayer within a given calendar year.

In particular, as regards the first condition, services are deemed to have been provided electronically where their supply is, by nature, automated, requiring the use of information technology but minimal human intervention.[12] The second condition limits the application of the tax to business-to-business (B2B) transactions by demanding that the recipient of the service be subject to business income tax.[13] The place where the transaction is carried out is irrelevant;[14] the only necessary condition is that the transaction pertain to Italian residents or PEs. Finally, the threshold of 3,000 transactions is aimed at restricting the scope of the tax to large multinationals with significant income from digital business activities, thus ring-fencing small companies and start-ups.

Where the above conditions are cumulatively satisfied, web tax applies at a 3% rate on the service fee charged, excluding VAT.[15] The respective amount must be indicated on the relevant invoice. The tax is withheld by the service recipient/payer of the service fee at the time of such payment and is remitted to the Italian tax authorities by the 16th day of the month following payment of the service fee.[16] An exemption is made if the service provider does not exceed the aforementioned threshold of 3,000 transactions within a specific year. This must be indicated on the invoice or other relevant documentation to allow the payer of the fee to abstain from withholding web tax.[17]

2.3. Pending issues

Furthermore, the Budget Law has authorized the enactment of implementing legislation to detail the application of these provisions. Specifically, a Ministerial Decree is to be issued by the end of April 2018 in order to:
– define the services falling within the scope of the web tax; and
– clarify obligations in relation to a tax declaration and payment of the tax, as well as any exemptions.[18]

The Italian Revenue Agency has also been authorized by the law to issue any additional necessary implementing rules.

Future legislation is hence expected to clarify the substantive and procedural questions left open by the Budget Law, which, amongst others, include:
– the practical application of the *3,000-transactions-per-year* threshold, especially in cases where the service provider is close to the limit and its appropriate communication to the recipient of the service, who must withhold the tax from the payment; and
– the application of web tax in conjunction with other direct taxes on income,[19] in particular whether or not the latter is to apply to the service fee following deduction of the web tax.

It follows that the Italian legislation is not yet complete, and any assessment of the legislation requires that a number of assumptions be made. What should also be taken into account is that the Italian 2018 elections might overhaul the landscape. Despite the uncertainties, the following sections attempt to provide some preliminary considerations on the Italian initiative from a domestic as well as international perspective, also in comparison to proposals being put forward internationally.

3. Input from the International Arena

3.1. Tax measures considered by the European Union

In September 2017, the European Commission stated its position on the debate on taxation of the digital economy in its Communication on "A Fair and Efficient Tax System in the EU for the Digital Single Market".[20] Declaring its intention to present a solid plan on the way forward early in 2018, the Commission prioritized the currently foreseeable solutions.

The amendment to the current PE definition – towards recognition of a virtual PE – is considered the most desirable solution. Such a definition should not require physical presence in order to acknowledge taxing power; sig-

9. On the domestic debate regarding the taxation of the web and sharing economy before the introduction of Web Tax, *see* M. Allena, *Italy – The Web Tax and Taxation of the Sharing Economy: Challenges for Italy*, 57 Eur. Taxn. 7 (2017), Journals IBFD.
10. Art. 1 paras. 1011 and 1017 Budget Law.
11. Id., at art. 1, paras. 1011 and 1013.
12. Id., at art. 1, para. 1012.
13. An additional requirement in this respect is that the recipient of the services not be subject to flat taxation. Thus, the law seeks to protect persons with limited business activities from the administrative obligations the web tax implies for recipients of the services/payers of the service fees.
14. Art. 1, para. 1013 Budget Law.
15. Id.
16. Id., at art. 1, para. 1014. With regard to procedures for assessment, application of sanctions and collection, the legislation makes reference to the provisions for VAT. *See* art. 1, para. 1016 Budget Law.
17. Id., at art. 1, para. 1014.
18. Id., at art. 1, paras. 1012 and 1015.
19. IT: Corporate Income Tax (*Imposta sul Reddito delle Società*, IRES) applicable at a rate of 24% and IT: Regional Tax on Productive Activities (*Imposta Regionale sulle Attività Produttive*, IRAP) applicable at a rate of 3.9%.
20. European Commission, *supra* n. 1.

nificant economic presence based on alternative criteria should suffice.[21] The adoption of this concept will necessitate corresponding amendments to the transfer pricing rules to take into due consideration value generated from intangibles. Although the Commission is committed to promoting such a solution in the context of the international debate, it seems to believe that achieving the required worldwide consensus is unrealistic. Therefore, it is considering less ambitious alternatives.

In the absence of international consent, the next best alternative is action at an EU level. In particular, the Commission argues for the urgent adoption of its 2016 Common Consolidated Corporate Tax Base (CCCTB) proposal,[22] tailored further to better address the specificities of the digital economy. Envisaging a single EU-wide tax base for groups of companies operating in the Single Market, the proposal provides an apportionment formula for the determination of the share of each Member State. Sales based on destination are one of the factors taken into account in the formula, along with assets and labour. Although the proposal is more appropriate than the existing legal framework for the taxation of corporate income in a digital world, the Commission has highlighted that it could be further enhanced to this end. Amendments can be expected in line with the OECD's position in its 2015 Final Report on Action 1,[23] in the context of the Base Erosion and Profit Shifting (BEPS) Project (analysed below in section 3.2.).

Both alternatives, i.e. a new PE definition and a digitalized CCCTB are expected to spark long debate before their adoption (if at all). For this reason, the Commission is promoting the enactment of short-term measures for the protection of Member States' tax rights. In this respect, and subject to a number of reservations regarding future examination, the Commission is considering:
– an equalization tax on turnover of digitalized companies;
– a withholding tax on digital transactions; and/or
– a levy on revenues generated from the provision of digital services or advertising activities.

The equalization tax would apply to "untaxed or insufficiently taxed income" from internet-based activities, thus bringing to mind the UK diverted profits tax, targeting tax avoidance in the context of the digital economy. The other two alternatives only seem to concern non-resident companies.[24]

3.2. Tax measures considered by the OECD

The above alternatives under examination by the European Commission are inspired by those the OECD considered in its Action 1 Final Report. At that stage, such solutions were regarded as being inadequately developed and therefore they were not recommended for adoption.[25] Nevertheless, the OECD is expected to work further along the same lines in order to fine-tune these options and proceed with recommendations.

The OECD, in fact, analysed a potential revision of the nexus approach that would recognize a significant economic presence as taxable, regardless of physical presence. Indicators of significant economic presence could include business profits realized in a given jurisdiction, the existence of a local domain name and/or payment options in local currency, the volume of user data collected, etc. In the Commission's view, this solution is the most desirable long-term alternative.

In addition, the OECD has referred to the option of a withholding tax on payments from residents to non-residents in the context of online transactions (goods and services), i.e. including in the context of e-commerce. It has also considered the imposition of an equalization levy on non-resident service providers with significant economic presence in a given jurisdiction.[26] Both these options are also under discussion by the Commission as possible short-term solutions to taxing income from digital business activities.

3.3. The web tax solution

The overview of the tax measures under consideration at an international and EU level in sections 3.1. and 3.2. reveals differences in relation to the Italian web tax. In essence, the Italian solution seems to be closer to the option of a withholding tax on digital transactions but with two core points of divergence. On the one hand, the web tax does not apply to e-commerce. It is explicitly restricted to the supply of services, which is almost entirely automated. On the other hand, the web tax burdens non-residents and residents equally, i.e. including persons taxable in Italy on their worldwide income. Interestingly, the original legislative proposal limited the scope of application of the web

21. It is worth noting that such a solution has already been adopted unilaterally by Israel. *See* IL: Circular 4/2016, *supra* n. 6. In addition, the concept of significant economic presence, separate from physical presence, was recognized and developed in a recent summary judgment of the Circuit of Illinois in the United States. In the decision, the Court stated that: "The Defendant urges the Court to adopt the significant economic presence test as being the fairest test of corporate income tax given the current internet based world. The Court agrees". In applying the test, the Court took into account four factors: (i) collection of fees and interest from residents of Illinois; (ii) the systematic and continuous promotion of services to Illinois consumers via phone, mail or e-mail; (iii) use of Illinois courts to recover debts; (iv) the filing and enforcement of liens in Illinois. *See* US: Illinois Circuit Summary Judgement, 11 May 2015, Case 2012-TX-0001/02, *Capital One Financial Corporation James Dunn v. Brian Hamer and Dan Rutherford, Treasurers.*
22. European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM(2016) 683 final (25 Oct. 2016), EU Law IBFD.
23. OECD, *Addressing the Tax Challenges of the Digital Economy – Action 1: 2015 Final Report* (OECD 2015), International Organizations' Documentation IBFD.
24. For a detailed analysis of the impact and merits of the tax measures under consideration in the EU context, *see* G. Kofler, G. Mayr & C. Schlager, *European Union – Taxation of the Digital Economy: "Quick Fixes" or Long-Term Solution?*, 57 Eur. Taxn. 12 (2017), Journals IBFD.
25. The sole exception was the amendment to the PE definition, which was implemented in *OECD Model Tax Convention on Income and on Capital* (21 Nov. 2017), Models IBFD. The amendment took into account the fact that activities supporting traditional business models could be fundamental under digital economy conditions.
26. For a detailed analysis of the measures considered by the OECD to address the tax challenges of the digital economy, *see* P. Valente, *Digital Revolution. Tax Revolution?*, Bull. Intl. Taxn. 4a, *Navigating the Tax Challenges of the Digital Economy*, Joint Special Issue with Tax Analysts (2018) [online only], Journals IBFD.

tax to payments to non-residents – without distinguishing EU from non-EU residents. In any event, a thorough evaluation of the web tax relative to the international proposals can only be undertaken once they are finalized.

4. Some Preliminary Remarks

4.1. In Italy

From a domestic viewpoint, the introduction of a web tax – as with every new tax – cannot but raise concerns and trigger debate, especially taking into account the lack of international precedent in this area.

A first point of conflict seems to be the law's expected impact on the national economy, despite the clear legislative intent to protect the state's tax base and ensure tax revenue from business activities in Italy. It can be argued that, in its current form, the law risks jeopardizing Italian businesses relative to their foreign competitors. As detailed above, web tax applies to digital transactions for the supply of services to Italian residents or PEs. Based on such a premise, Italian residents can be expected to constitute the majority of the clientele of Italian service providers, while only a small proportion of the clientele of foreign service providers. It follows that any additional charges based on clientele are expected to be less burdensome for the latter, since they will arise only in relation to a small share of a diffused client base.

The implications of this are better understood taking into account the additional cost the new tax implies for digital service providers. Although exact calculations of such a cost necessitate further clarifications as regards the application of the web tax in relation to direct income taxes in force in Italy, without doubt, service providers that fall within the scope of the new tax will see their net income decreased by 2.163% to 3%.[27] Hence, they will have to decide between (i) increasing their service fees; and (ii) bearing the new cost themselves in order to keep their prices competitive. In such a context, service providers affected the most by the new tax that are not able to absorb the additional cost are more likely to increase their prices. Alternatively, opting to absorb the cost means bearing the negative consequences of decreased cash flow in respect of one's margin for new investment and business development.

Furthermore, each new tax could undermine the attractiveness of the internal market for new or further investment. Such a risk is increased where equivalent internal markets around the world offer more favourable tax conditions. This is the case with web taxation, which, to date, is only applied in a few countries.[28] In assessing this risk, it should be taken into account that the digital services sector is experiencing an evolutionary peak and is reasonably expected to attract increasing investment in the near future. In such circumstances, economic growth and sustainability demand incentives for investment, both domestic and foreign, in the area of digital services or – in the web tax scenario – neutralization of any disincentives.

The implications of the new tax are expected to expand to the entire Italian market, i.e. beyond the digital services sector. In fact, a potential increase in the price of online services in Italy will probably translate into higher costs for Italian businesses requesting such services. It follows that they will have to either bear such costs or opt for traditionally provided services. The extra administrative burden and liability risk a web tax implies for the recipient of digital services could be a further argument in favour of traditional economy options. In particular, Italian recipients of online services must act as withholding agents with regard to the web tax on service fees. This means that they must calculate, withhold and remit the amount of tax due to the Italian tax authorities within a specific timeframe. Non-compliance results, in principle, in joint liability of the service provider and the withholding agent. If the web tax were to function as an incentive to return to the traditional economy, Italy might slow down its rate of digitalization at the same time the rest of the world is speeding up.[29]

Finally, the new legislation is likely to enhance taxpayer uncertainty in the domestic market. In its current form, there are a lot of important pending questions. Hopefully, they will be answered in the next few months in a forthcoming Ministerial Decree. However, even in such a scenario, several months will have lapsed between the introduction of the obligation and taxpayer certainty on the burden it implies. In business terms, this might mean unnecessary challenges in the context of tax risk management and a subsequent slowdown of investment. Notably, the most evident characteristic of digitalization is that it accelerates procedures.

What the above indicates is that the web tax might undermine the Italian business environment if not clearly and carefully structured in a timely manner. In this respect, it will be essential for the new burden to be compensated for by adequate incentives for investment and digitalization. It is equally crucial that the Italian tax authorities adopt a service-oriented and cooperative position to assist taxpayers with compliance. There is little experience with taxation of digital activities but this, in itself, must not discourage relevant legislative steps. Taxation of the digital economy is bound to become a routine matter, hopefully in an optimal way.

27. The final amount will depend on whether direct income taxes apply following the deduction of the web tax from the service fees.
28. Although taxes on income from digital activities are expected to be widely established very soon, currently, the majority of countries are waiting for international initiatives and do not apply such tax regimes.
29. According to Europe's Digital Progress Report 2017, Italy was ranked 25th out of 28 Member States in terms of digitalization of the economy and society, meaning that its pace of digitalization is already slow. Specifically, Italy was found to be close to the average as regards the use of digital technology by businesses and the online provision of public services. Despite progress in terms of connectivity, poor digital competencies seem to prejudice development of the digital economy and society in Italy. *See* European Commission, Europe's Digital Progress Report (EDPR) 2017 Country Profile Italy (2017).

4.2. At the international level

From an international perspective, the introduction of the web tax by Italy signifies a unilateral step amidst heated discussions at the EU and OECD levels regarding identifying acceptable solutions to taxing digital business. In its aforementioned Communication[30] the European Commission strongly emphasized the need for – ideally worldwide – agreement on the matter. In any event, agreement within the European Union will be a prerequisite to solutions in line with the principles and objectives of the Single Market. Otherwise, there is a risk that the result will be 28 conflicting tax regulations. Coordination of Member States will also grant the European Union the necessary loud and confident voice to push for action within the OECD and the international arena.

Digitalization is, by nature, a global phenomenon that cannot be restricted to national boundaries. It demands compromises of national interests, cooperation and consent to be regulated and taxed effectively. The more unilateral the actions, the further we will stray from appropriate solutions and create opportunities for tax avoidance.

Italy's introduction of the web tax reflects the reasonable concerns of an active state seeking to protect its rights and citizens as a whole. The European Commission, on its part, has recognized that unilateral action in the sensitive context of the digital economy is justifiable and foreseeable.[31] Given the risk of harm to the integrity of the European Union and the smooth functioning of the Single Market, Italy's initiatives are raising alarm bells that action must be taken soon. Final concrete proposals can no longer be postponed; the discussions thereon must happen quickly and be decisive and effective since there has already been a delay. Digitalization goes hand-in-hand with globalization and demands strong supranational authorities capable of governing such phenomena. In this sense, Italy's unilateral action may represent the beginning of better alignment, stronger coordination and more harmonization, at least amongst Member States.

5. Conclusion

This article has sought to provide an overview of the web tax legislation recently enacted in Italy. To this end, it detailed the framework prescribed by the new provisions and then moved on to the alternative solutions under discussion in the international arena. Some preliminary concerns regarding the new tax – that can be raised at both the domestic and worldwide level – were also addressed. With the web tax, Italy has made a risky but also courageous decision. It is hoped this action will be the key to unlocking coordinated international action.

30. European Commission, *supra* n. 1.

31. European Commission, *supra* n. 1.