



WTS VAT Update for the Digital Economy

Italian Digital Service Tax (II)

1. ITALIAN DIGITAL SERVICE TAX

Since 1 January 2020, Italy has had a Digital Service Tax ("DST"). On 17 December 2020, after almost one year after the DST had entered into force, the Italian Tax Authorities ("ITA") issued a draft document (the "Draft") that has provided further explanation and clarification on the DST. The Draft was also open to public consultation until the end of 2020.

The Draft has overviewed the various provisions laid down in the DST, and has confirmed that the DST applies to taxpayers (whether Italian resident or not) satisfying – either standalone or at a group level – both of the following requirements for the calendar year prior to the one in which the DST comes due (i.e., for the first time, 2019 vis-a-vis 2020):

- the amount of worldwide revenues reported by the entity concerned is at least equal to Euro 750 million;
- the amount of revenues, generated in Italy, from qualified digital services is at least equal to Euro 5.5 million.

It is worth noting that the second threshold (qualified digital services revenues generated in Italy) has to be calculated using a specific method (an "operational ratio" – see below); this implies a retroactive application of the accounting obligations, which could be a possible infringement of the legal provision on taxpayers' general guarantees (Italian Law No. 212/200).

As set out in our previous [WTS Global Update](#), the Italian DST is due at the rate of 3% on gross revenues (net of VAT and other indirect taxes) generated from B2B and B2C activities in a given calendar year on digital services that are within the scope of the Italian DST, i.e. for any user who is located in Italy.

1. SCOPE

The digital services that are within the DST's scope are:

- a. the placing on a digital interface of advertising targeted at users of such an interface;
- b. the provision of a digital multilateral interface connecting users and letting them interact, even for facilitating the direct – among the same users – supply of goods or services;
- c. the transmission of data collected about users and generated from users' activities on digital interfaces.

However, the Draft provides a list of exclusions, such as:

- the direct sale of goods or provision of services performed in the context of an intermediation service; or
- the supply of goods or services ordered through the website of the same supplier when the latter does not act as an intermediary; or
- the making available of a digital interface where the sole or main purpose is to supply digital content, communication services or payment services to users.

The DST does not apply to goods and services provided between affiliated companies. Intercompany and financial services are also excluded from the DST's scope.

2. KEY DEFINITIONS

The Draft provides a further explanation on specific definitions used in the DST. We note that its key elements have been given rather broad definitions:

- Digital Content, which includes any data provided in digital format, such as software programs, apps, videos, music, games, etc. irrespective of whether the access to such data takes place through downloading or streaming.
- The same broad definition is also applied to the notion of Digital Interface, which qualifies it as any software (including websites or apps), through which the digital services are supplied.
- Taxable Revenues, which have to be calculated on a cash basis (not on an accrual basis) per calendar year.
- Specific attention is given to the notion of User, which is considered to be any individual connecting through a device to a digital interface to make use of the digital services. The nexus with Italian territory is created for the purpose of the DST's application when such a User enjoys digital services through a device located in the Italian territory.

3. SAAS

The Draft states that the DST only applies to the supply of digital services, clearly excluding revenues gained from the direct supply of goods and services ordered through a supplier's website, as well as the direct supply of goods and services in the context of a digital intermediation service.

The provision of SaaS-based services thus appears not to be within scope of the Italian DST.

4. FINANCIAL SERVICES

Financial Services are also beyond the DST's scope. We note that the definition of "Financial Services" for the DST's purpose is, to a certain extent, still unclear. Granting loans and/or taking care of third party payments for online purchases is clearly not within the DST's scope. However, like other DST proposals, the Italian DST lacks a definition of "Financial Services". Furthermore, like other DST proposals, the Italian DST also does not include a further explanation on so-called "Composite Supplies".

As a result, it cannot be fully excluded that certain Bank and PSP products could very well come (partially) within the DST's scope. We therefore recommend Financial Institutions and PSPs to carefully review their business lines to identify potential Italian DST liabilities.

5. M&A REORGANISATION IMPACT

The impact of any DST, in this case the Italian DST, is not only limited to the day-to-day business of digital MNEs. We expect that DSTs will have a lasting impact on International M&A and reorganisation activities as well. Furthermore, we strongly recommend MNEs that (partially) offer, or intend to offer, online business lines, to incorporate a full DST review into their M&A process.

The acquisition of a company, group of companies, or just the acquisition of IP, could trigger the risk of exceeding the thresholds and falling within the DST's scope. The same would apply following the creation of new online products or business lines as a result of such an acquisition. Furthermore, to the extent that the transfer of user data is within the Italian DST's scope, the sale or acquisition of a company or IP that implies the transfer of data could trigger a DST liability on its own.

Given the fact that the DST triggers substantial compliance obligations, and more importantly, that the DST most likely will affect pricing and/or margins of the products or business lines coming within its scope, we strongly recommend reviewing any possible DST impact before entering into M&A transactions.

6. RELEVANT FORMALITIES

a) Collection of the DST

The Draft furthermore has confirmed the two relevant annual deadlines relating to the submission as well as the payment of the DST. The dates are:

- **16 February**, for the payment of the DST;
- **31 March**, for the submission of the annual DST Return.

We note that the above dates apply as from 2021, as a result of which the DST due for 2020 should be reported by 31 March 2021 and paid by 16 February 2021.

As for the DST's payment, it is established that taxpayers are required to pay through the F24 Form, which is to be charged to an Italian bank account (in a separate document, the ITA will establish the relevant tax codes to be stated in the F24 Form for the payment). However, non-resident taxpayers, i.e. without an Italian bank account, who are not able to use the F24 Form, may pay the tax through a bank transfer.

b) Calculating the Italian DST

Further to the above, the Draft provides for further clarifications regarding the actual calculation of the different types of digital services. These calculations can be summarised as follows:

i) Advertising services

The in scope revenues include both those from the publishing of advertisements on third parties websites as well as those from advertisements directly hosted on a particular website. The DST is applied in the following ratio for messages appearing on certain Digital Interfaces:

Advertising messages of users located in Italy / total messages (worldwide) = RATIO

DST = 3% x RATIO x WORLDWIDE ADVERTISING SERVICES REVENUES

ii) Intermediation and Marketplace services

The in scope revenues are only those paid by the Users of the digital interface, net of the consideration paid for the sale of the goods and services. The DST applies in the following ratio:

Transactions concluded by users located in Italy / total number of the transactions (worldwide) = RATIO

DST = 3% x RATIO x WORLDWIDE INTERMEDIATION AND MARKETPLACE SERVICES REVENUES

iii) Data transmission

The in scope revenues are those from the transmission for consideration of the data obtained from the User activity on the digital interfaces. The DST applies in the following ratio, considering the data sold and transmitted:

Number of users located in Italy / entire amount of the Users (worldwide) = RATIO

DST = 3% x RATIO x WORLDWIDE DATA TRANSMISSION REVENUES

Do note that there is still a lot of uncertainty regarding these calculations. For instance how to identify and treat Users using multiple devices. Or, for instance, how to calculate the DST in the case of so-called Package Deals, Composite Supplies or Barter transactions. Nevertheless, the calculation of the Italian DST must be done separately for each entity that remains responsible for the correct payment and the filing obligations.

c) Accounting Obligations

As set out, the Draft applies to all revenues collected in the underlying calendar year by each of the DST subjects, considering the gross amount of the costs for the supply of the digital services, but net of VAT and other indirect taxes.

The Draft also confirms the legal provisions regarding the accounting obligations. For instance, DST-liable taxpayers are required to set up specific monthly bookkeeping to account for qualified revenues from digital services and to give evidence of the criteria through which a portion of their qualified worldwide revenues is allocated in Italy. We note that the provisions are rather specific. However, to proceed with the actual payment and filing of the Italian DST, the F24 Form payment code, the DST Return Form and related instructions have still to be approved by separate Regulations.

In particular, the information underlying the DST calculation (see above) must be reported in the "Analytical statement of information on revenues and figures used for the tax calculation" (Annex 1 to the Draft is to be drawn up within the deadline for the payment of the tax, i.e. by 16 February 2021).

Furthermore, a report entitled "Explanatory note on the information on revenues and figures used for the tax calculation" (Annex 2) has to be drawn up annually,

before the deadline for submitting the DST Return (i.e. by 31 March 2021). In this respect, the ITA have specified that the monthly bookkeeping must be kept on a storage memory that guarantees the inalterability and preservation of the recorded data (e.g. an optical disk).

d) Group Companies

According to the Draft, when revenue thresholds are exceeded at the group level, each of the companies belonging to the group could qualify as a DST taxable person. Italian-resident companies belonging to the same group as non-resident DST taxable persons will be jointly liable for obligations related to the DST.

It is possible for Group Companies to appoint a "**Designated Company**", which may comply with all the DST formalities (i.e. the annual payment and DST return) on behalf of the affiliate entities, based on the data and information provided by each entity. The Designated Company must be a DST subject; any company resident in a country without a Tax Information Exchange Agreement ("**TIEA**") with Italy, and without a permanent establishment in Italy, are not eligible for such a designation.

The appointment is made on an annual basis.

Irrespective of the appointment of a Designated Company, each of the entities of the group should have or must obtain a fiscal code in Italy if they are not resident or established in Italy.

e) Fiscal Representative

Furthermore, DST liable taxpayers without an Italian CIT PE, established in a country without a TIEA with Italy, must appoint a fiscal representative in Italy. It is strongly recommended to verify whether your company or companies would require an Italian Fiscal Representative.

In the case of a Group non-resident in Italy but subject to the Italian DST; where one of the affiliate entities is resident in Italy, such entity will be jointly responsible for the DST payment of the other non-resident taxpayers of the Group, provided that the latter are resident in countries without a TIEA with Italy, and have no CIT PE in Italy (the language of the Draft literally says "with TIEA", but we assume that is a typo).

f) Penalties

VAT penalties apply, in principle, to the Italian DST (the reference is explicitly made by the Draft). As a consequence, a penalty from 90% to 180% of the DST due applies in the case of an unfaithful tax Return, and a 30% penalty applies for omitted or late payment of the DST due. As noted above, the Draft was in an open public consultation until 31 December 2020. During that period, taxpayers and other interested parties were able to submit, by email, their proposed amendments to the current version.

In response to the Italian DST effort, the Office of the United States Trade Representative Executive Office of the President, has carried out a so-called Section 301 investigation in which the US government analysed the Italian DST's legal merits. The results of this investigation have indicated that:

- Italy's DST, by its structure and operation, discriminates against U.S. digital companies, including due to the selection of covered services and the revenue thresholds.
- Italy's DST is unreasonable because it is inconsistent with principles of international taxation; including due to its application to revenue rather than income and extraterritoriality.
- Italy's DST burdens or restricts U.S. commerce.

For a copy of the full report please see [here](#).

For now it is hard to predict any follow-up action by the US government. In 2019, the US decided to impose an additional 25% tariff on some French goods in retaliation against the implementation of the French DST. However, in early January 2021, the US announced a delay in implementing this 25% additional tariff. The latter also has been in light of the transitional status of the current US government. For that reason, we find that it is hard to predict the US's reaction to the Italian DST.

7. TAKEAWAY

While the approach of the ITA must be appreciated, since it has been open to listening to taxpayers, it should be noted that not all doubts have been solved and certain, if not so numerous, questions still need to be specifically answered. The Italian DST in this respect does not differ from others, as it leaves companies that are within its scope, or are expected to be within its scope, with significant open issues.

Important issues deriving from the DST's unilateral introduction have not been addressed. In particular, the DST could breach the Constitutional principle of taxable capacity, as applying the DST to gross revenues (irrespective of the actual profits) does not respect the non-discrimination principle, since it applies only to a specific industry.

After the implementation of the French DST and the Spanish DST, which have proven to be a challenge for the companies concerned, companies operating in the digital economy now face the implementation of the Italian DST. To the extent that the Italian DST applies a significantly lower threshold, which is calculated at group level, more companies could be liable under the Italian DST.

Based on our first review of the Draft, we strongly recommend companies that operate within the scope of the Italian DST to proactively review and verify if, and if so, to what extent, their operations are indeed taxable under the "new" Italian DST.

In the event companies are within the scope of the Italian DST, it is highly recommended to review and verify their customer on-boarding procedures to determine whether the required information complies with the Italian DST liabilities and to calculate whether the Italian DST due is available or not. Also, we recommend reviewing the underlying contracts and Terms & Conditions to ensure that they are aligned with the "new" Italian DST obligations.

In addition, we also recommend reviewing and determining the compliance obligations that are triggered by the Italian DST, as well as reviewing to what extent your company can comply by verifying the required registrations, Fiscal Representatives, etc. Companies subject to the DST are required to set up specific monthly bookkeeping to account for qualified revenues from digital services and to give evidence of the criteria through which a portion of qualified worldwide revenues is allocated in Italy. In the case of revenues collected in a foreign currency (i.e. other than the Euro), the official exchange rate – published in the EU Official Journal – will be applied.

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