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Section 301 Investigation

Report on Italy's Digital Services Tax

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Contents

Executive Summary i

I. Background 1

A. Italy's Unilateral Adoption of the Digital Services Tax Amidst Ongoing Organisation for Economic Co-operation and Development Discussions 1

B. Background of the Investigation 2

1. Relevant Elements of Section 301 3

2. Focus of the Investigation 4

3. Input from the Public 4

II. Italy's Digital Services Tax 4

A. Features of Italy's Digital Services Tax 4

B. Covered Companies 9

C. The European Commission's Digital Services Tax Proposal 10

III. USTR's Findings Regarding Italy's DST 14

A. Italy's Digital Service Tax Discriminates Against U.S. Companies 14

1. The Revenue Thresholds Discriminate Against U.S. Companies 14

2. The Selection of Covered Services Under the Italian DST Discriminates Against U.S. Companies 15

B. Italy's DST is Unreasonable Because the DST's Application to Revenue Rather Than Income Is Inconsistent with International Tax Principles 18

1. Italy's DST is Unreasonable Because Taxing Revenue Rather Than Income Fundamentally Alters the Tax Environment for Covered U.S. Companies 21

2. The DST's Application to Revenue Results in Double Taxation 22

C. Italy's DST is Unreasonable Because it is Extraterritorial in a Manner that Is Inconsistent with International Tax Principles 23

D. Italy's DST Burdens or Restricts U.S. Commerce 26

1. DST Liability Is a Burden on U.S. Companies 26

2. The Italian DST's User Location Provision Is a Burden for Covered U.S. Companies 26

3. Italy's Lack of DST Regulations and Guidance Is a Burden 27

IV. Conclusion 29

Annex 1: Italy's Digital Service Tax (English Translation) 30

Annex 2: Letter from Ambassador Robert Lighthizer to the Government of Italy 35

Report on Italy's Digital Services Tax Prepared in the Investigation Under Section 301 of the Trade Act of 1974

EXECUTIVE SUMMARY

In 2013, the Organisation for Economic Co-operation and Development (OECD) and G20 countries began negotiations to address taxation matters related to the digitalization of the economy. Despite ongoing OECD discussions, the European Commission (EC) introduced a digital services tax proposal on March 21, 2018. After it became clear that the Commission's proposal was not going to receive unanimous support, the Italian government adopted its own unilateral DST. However, OECD reports have made it clear that "[t]here is no consensus on either the merit or need for interim measures," while discussions continue.

Italy adopted the operative form of its *imposta sui servizi digitali*, or Digital Services Tax (DST), on December 27, 2019. The DST applies to companies that, during the previous calendar year, generated €750 million or more in "worldwide" revenues and €5.5 million or more in revenues "deriving from the provision of digital services," as defined by the DST, in Italy.

On June 2, 2020, the U.S. Trade Representative initiated an investigation of Italy's DST under section 302(b)(1)(A) of the Trade Act of 1974, as amended (the Trade Act). Section 301 of the Trade Act sets out three types of acts, policies, or practices of a foreign country that are actionable: (i) trade agreement violations; (ii) acts, policies or practices that are unjustifiable (defined as those that are inconsistent with U.S. international legal rights) and burden or restrict U.S. commerce; and (iii) acts, policies or practices that are unreasonable or discriminatory and burden or restrict U.S. commerce. If the Trade Representative determines that an act, policy, or practice of a foreign country falls within any of the categories of actionable conduct, the Trade Representative must determine what action, if any, to take.

As discussed in this report, the investigation identified unreasonable, discriminatory, and burdensome attributes of Italy's DST.

<u>Italy's DST discriminates against U.S. companies</u>. Both the DST's revenue thresholds and selection of covered services discriminate against affected U.S. companies. Due to the revenue thresholds, over 62 percent of companies likely affected by Italy's DST are U.S. companies, whereas less than seven percent of likely affected companies are Italian companies. Additionally, the narrow definition of covered services under Italy's DST targets services where U.S. companies are market leaders.

<u>Italy's DST is unreasonable because it is inconsistent with prevailing international tax principles</u>. Italy's DST applies to revenue rather than income; Italy's DST applies to revenues unconnected to a physical presence in Italy; Italy's DST is extraterritorial; and Italy's DST results in double taxation. As such, the DST is unreasonable as it deviates from the prevailing tax principles of international corporate taxation.

<u>Italy's DST imposes a wide range of burdens</u>. Italian DST liability constitutes a burden on covered U.S. companies. Additionally, Italy's DST has lacked implementing regulations and guidance, which result in financial, administrative, and compliance burdens on covered U.S. companies.

Conclusions

The results of this investigation indicate that:

(1) 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.

(2) Italy's DST is unreasonable because it is inconsistent with principles of international taxation; including due to application to revenue rather than income and extraterritoriality.

(3) Italy's DST burdens or restricts U.S. commerce.

I. BACKGROUND

A. ITALY'S UNILATERAL ADOPTION OF THE DIGITAL SERVICES TAX AMIDST ONGOING ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT DISCUSSIONS

In 2013, the Organisation for Economic Co-operation and Development (OECD) and G20 countries began negotiations to address taxation matters related to the digitalization of the economy.[1] Despite ongoing OECD negotiations, the European Commission (EC) introduced a digital services tax proposal on March 21, 2018. European Union (EU) members debated the proposal at length but certain EU members, including Ireland, Sweden, and Denmark, opposed the DST.[2] Under EU law, tax-related legislation at the EU level requires unanimous member state support.[3] After it became clear that the Commission's proposal was not going to receive unanimous support, the Italian government adopted its own unilateral DST.[4]

OECD reports have made clear that "[t]here is no consensus on either the merit or need for interim measures," referring to unilateral digital services taxes, while discussions continue.[5] Notwithstanding, Italy introduced an *imposta sui servizi digitali*, or Digital Services Tax (DST), as part of the 2018 Italian Budget Law, and again as part of the 2019 Italian Budget Law. The 2019 Budget Law passed on December 30, 2018.[6] This law contained general principles of application for a DST.[7] The law referenced implementing measures for a DST that were expected in May 2019, but were never issued.[8] The referenced DST also never went into effect.[9] Italy adopted amendments creating an operational DST on December 27, 2019.[10] The DST took effect and liability obligated as of January 1, 2020.[11] Implementing measures were not proposed until approximately December 17, 2020, and are not likely to take effect in 2020.[12] The first DST payments are expected to come due in February 2021, despite lack of clarity for most of

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[1] *See* OECD, Action Plan on Base Erosion and Profit Shifting, July 19, 2013.

[2] Jorge Valero, *The EU's digital tax is dead, long line the OECD's plans*, EURACTIV (Mar. 11, 2019), https://www.euractiv.com/section/economy-jobs/news/the-eus-digital-tax-is-dead-long-live-the-oecds-plans/.

[3] *See* European Commission, *Decision making on EU Tax Policy*, EUROPA.EU, https://ec.europa.eu/taxation_customs/taxation/decision-making-eu-tax-policy_en (last visited Dec. 5, 2020).

[4] Emanuele Franchi, et al., *Italy's draft 2020 budget calls for unilateral digital services tax,* PWC (Nov. 14, 2019), https://www.pwc.com/us/en/services/tax/library/insights/italy-draft-2020-budget-calls-for-unilateral-digital-services-ta.html.

[5] Org. for Economic Co-operation and Development, *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS*, at 178 (OECD Publishing 2018), https://read.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-interim-report_9789264293083-en#page180.

[6] Legge 30 dicembre 2018, n. 145, art. 1 (It.).

[7] *Id.*; *see also* Christian Montinari & Alberto Sandalo, *Italian digital tax under reshaping to come into force in 2020*, IPOSA (Dec. 2, 2019), https://www.ipsoa.it/documents/fisco/imposte-dirette/quotidiano/2019/12/02/italian-digital-tax-under-reshaping-to-into-force-2020.

[8] *Id.*

[9] *Id.*

[10] Legge 27 dicembre 2019, n. 160, art. 1, para. 678 (It.).

[11] Legge 27 dicembre 2019, n. 160, para. 47 (It.).

[12] Comments of Computer & Communications Industry Association (CCIA), 3-4, USTR-2020-0022-0329 (Jul. 14, 2020).

calendar year 2020, as to what companies may be covered by the DST and as to how the DST will be applied.[13]

OECD and G20 countries have already decided on some specific actions that countries should implement to improve the operation of the international tax system.[14] Against this backdrop, OECD reports have cautioned against unilateral DSTs, noting that "it is expected that any consensus-based agreement must include a commitment by members . . . to withdraw relevant unilateral actions, and not adopt such unilateral actions in the future."[15]

The adoption of Italy's DST in the absence of an international consensus reinforces concerns that Italy has chosen a measure that unfairly targets large, U.S.-based technology companies and that Italy's DST is inconsistent with current principles of international taxation.[16]

Furthermore, unilateral laws like Italy's DST undermine progress in the OECD by making an agreement on a multilateral approach to digital taxation less likely.[17] If unilateral measures proliferate while negotiations are ongoing, countries lose the incentive to engage seriously in the negotiations. For this reason, among others, the United States has discouraged governments from adopting country-specific DSTs. Nonetheless, Italy has chosen to create and implement its own unilateral tax on digital services.

B. BACKGROUND OF THE INVESTIGATION

On June 2, 2020, the U.S. Trade Representative initiated an investigation of Italy's DST under section 302(b)(1)(A) of the Trade Act.[18] On the same date, the Trade Representative requested consultations with the Government of Italy.[19] Minister of Foreign Affairs and International Cooperation Luigi Di Maio replied on August 18, 2020.[20] Consultations regarding Italy's DST were held on November 10, 2020.

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[13] Legge 27 dicembre 2019, n. 160, para. 42 (It.); Paolo Ruggiero & Francesco Cardone, *INSIGHT: Italy Taxes the Digital Economy*, BLOOMBERG TAX (Jan. 29, 2020) https://news.bloombergtax.com/daily-tax-report-international/insight-italy-taxes-the-digital-economy.

[14] *See* OECD, OECD presents outputs of OECD/G20 BEPS Project for discussion at G20 Finance Ministers' meeting, Oct. 5, 2015; OECD, BEPS 2015 Final Reports, Oct. 5, 2015, https://www.oecd.org/ctp/beps-2015-final-reports htm.

[15] Org. for Economic Co-operation and Development, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint*, 211 (OECD Publishing 2018), https://read.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-report-on-pillar-one-blueprint_beba0634-en#page213; Legge 27 dicembre 2019, n. 160, art. 1, para. 49 *bis* (It.).

[16] *See generally* Initiation of Section 301 Investigations of Digital Services Taxes, 85 Fed. Reg. 34,709 (Jun. 5, 2020).

[17] *See*, *e.g.*, OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, 9, OECD PUBLISHING (Oct. 14, 2020).

[18] Initiation of Section 301 Investigations of Digital Services Taxes, 85 Fed. Reg. 34,709, 34,710 (Jun. 5, 2020).

[19] *See* Letter from Ambassador Robert Lighthizer to Minister Luigi Di Maio, June 2, 2020 (Annex 2).

[20] *See* Letter from Minister Luigi Di Maio, Minister of Foreign Affairs and International Cooperation, to Ambassador Robert Lighthizer, U.S. Trade Representative, Aug. 18, 2020 (on file with USTR).

As set out in the Notice of Initiation, the investigation involves determinations of whether the act, policy, or practice at issue—i.e., Italy's DST—is actionable under Section 301 of the Trade Act, and if so, what action, if any, to take under Section 301. This report provides analysis relevant to a determination of actionability under Section 301.

1. Relevant Elements of Section 301

Section 301 sets out three types of acts, policies, or practices of a foreign country that are actionable: (i) trade agreement violations; (ii) acts, policies or practices that are unjustifiable (defined as those that are inconsistent with U.S. international legal rights) and burden or restrict U.S. commerce; and (iii) acts, policies or practices that are unreasonable or discriminatory and burden or restrict U.S. commerce.[21] Section 301 defines "discriminatory" to "include . . . any act, policy, and practice which denies national or most-favored nation treatment to United States goods, service, or investment."[22] "[U]nreasonable" refers to an act, policy, or practice that "while not necessarily in violation of, or inconsistent with, the international legal rights of the United States is otherwise unfair and inequitable."[23] The statute further provides that, in determining if a foreign country's practices are unreasonable, reciprocal opportunities to those denied U.S. firms "shall be taken into account, to the extent appropriate."[24]

If the Trade Representative determines that the Section 301 investigation "involves a trade agreement," and if that trade agreement includes formal dispute settlement procedures, USTR may pursue the investigation through consultations and dispute settlement under the trade agreement. Otherwise, USTR will conduct the investigation without recourse to formal dispute settlement.

If the Trade Representative determines that the act, policy, or practice falls within any of the three categories of actionable conduct under Section 301, the USTR must also determine what action, if any, to take. If the Trade Representative determines that an act, policy or practice is unreasonable or discriminatory and that it burdens or restricts U.S. commerce:

> [T]he Trade Representative shall take all appropriate and feasible action authorized under [section 301(c)], subject to the specific direction, if any, of the President regarding any such action, and all other appropriate and feasible action within the power of the President that the President may direct the Trade Representative to take under this subsection, to obtain the elimination of that act, policy, or practice.[25]

Actions authorized under Section 301(c) include: (i) suspending, withdrawing, or preventing the application of benefits of trade agreement concessions; (ii) imposing duties, fees, or other import restrictions on the goods or services of the foreign country; (iii) entering into binding agreements that commit the foreign country to eliminate or phase out the offending conduct or to provide compensatory trade benefits; or (iv) restricting or denying the issuance of service sector

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[21] 19 U.S.C. § 2411(a)-(b).

[22] 19 U.S.C. § 2411(d)(5).

[23] 19 U.S.C. § 2411(d)(3)(A).

[24] 19 U.S.C. § 2411(d)(3)(D).

[25] 19 U.S.C. § 2411(b).

authorizations, which are federal permits or other authorizations needed to supply services in some sectors in the United States.[26]

2. Focus of the Investigation

The focus of this investigation is: "[d]iscrimination against U.S. companies; retroactivity; and possibly unreasonable tax policy. With respect to tax policy, the DSTs may diverge from norms reflected in the U.S. tax system and the international tax system in several respects. These departures may include: [e]xtraterritoriality; taxing revenue not income; and a purpose of penalizing particular technology companies for their commercial success."[27]

Additionally, USTR invited comments as to the extent to which the DST burdens or restricts U.S. commerce as well as other aspects that may warranft a finding that Italy's DST is actionable under Section 301.[28]

3. Input from the Public

USTR provided the public and other interested persons with opportunities to present their views and perspectives on Italy's DST. The Initiation Notice invited written comments by July 15, 2020.[29] More than 380 public comments were filed in response to the Initiation Notice.[30] USTR received comments by businesses, industry associations, and other groups that supported the Section 301 investigation and provided information and arguments in support of the bases identified in the Initiation Notice.[31]

II. ITALY'S DIGITAL SERVICES TAX

This section describes the structure and expected operation of Italy's DST.[32] Subsection A describes the content of Italy's DST. Subsection B discusses the companies likely covered by the DST. Subsection C discusses the proposal on which Italy's DST is based.

A. FEATURES OF ITALY'S DIGITAL SERVICES TAX

The Italian DST imposes a three percent levy on the gross taxable revenues generated from three categories of taxable services: (1) "targeted advertising" services, (2) "digital interface" services and (3) data transmission services. The DST applies to revenues "if the user of a taxable service is located in the territory of the State [Italy] in such period [during the

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[26] In cases in which USTR determines that import restrictions are the appropriate action, preference must be given to the imposition of duties over other forms of action. 19 U.S.C. §§ 2411(c).

[27] *Initiation of Section 301 Investigations of Digital Services Taxes*, 85 Fed. Reg. 34,709, 34,710 (June 5, 2020).

[28] *Id.*

[29] *Id.* at 34,709.

[30] *See Initiation of Section 301 Investigations of Digital Services Taxes*, Docket USTR-2020-0022, REGULATIONS.GOV.

[31] *See*, *e.g.*, Silicon Valley Tax Directors Group, Comment Letter Re: Written Submission in Response to Initiation of Section 301 Investigations of Digital Services Taxes (USTR-2020-0022), 14-25 (Jul. 15, 2020).

[32] This report regarding Italy's DST is for the limited purpose of this investigation under Section 301 of the Trade Act.

calendar year]".[33] The DST applies to companies that meet both global and Italian revenue thresholds for the covered services. DST liability began accruing on January 1, 2020.[34] The first payments under the DST are not anticipated to occur until February, 2021.[35] Public-source estimates indicate that Italy's DST will generate €708 million in tax revenue annually.[36]

Covered Services

The DST applies to revenue generated from the provision of the following services:

a) the placing on a digital platform of advertising targeted to the users of the platforms;

b) the making available to users of a multi–sided digital interface which allows users to find other users and interact with them and which may also facilitate the provision of underlying supplies of goods or services directly between users.

c) the transmission of data collected about users and generated from users' activities on digital interfaces.[37]

The definition of digital services under Italy's DST excludes certain categories of services, such as:

- "the provision of underlying supplies of goods or services directly between users, in the context of a digital intermediation service;"[38]

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[33] Legge 30 dicembre 2018, n. 145, para. 40 (It.).

[34] Legge 27 dicembre 2019, n. 160, para. 47 (It.); *see also* Letter from Minister Luigi Di Maio, Minister of Foreign Affairs and International Cooperation, to Ambassador Robert Lighthizer, U.S. Trade Representative, Aug. 18, 2020 (on file with author).

[35] Legge 27 dicembre 2019, n. 160, para. 32 (It.).; *see also* Letter from Minister Luigi Di Maio, Minister of Foreign Affairs and International Cooperation, to Ambassador Robert Lighthizer, U.S. Trade Representative, Aug. 18, 2020 (on file with author).

[36] Emanuele Franchi, et al., *Italy's draft 2020 budget calls for unilateral digital services tax*, 1, TAX INSIGHTS FROM INT'L TAX SERVS., PWC (Nov. 14, 2019), https://www.pwc.com/us/en/tax-services/publications/insights/assets/pwc-italy-draft-2020-budget-calls-for-unilateral-digital-services-tax.pdf.

[37] Legge 30 dicembre 2018, n. 145, art. 37 (It.); *Compare id. with Commission Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services*, 24, COM (2018) 148 final (Mar. 21, 2018) (hereinafter "EU DST Proposal") (defining "Taxable revenues" as: "[t]he revenues resulting from the provision of each of the following services by an entity shall qualify as 'taxable revenues' for the purposes of this Directive: (a) the placing on a digital interface of advertising targeted at users of that interface; (b) the making available to users of a multi-sided digital interface which allows 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; (c) the transmission of data collected about users and generated from users' activities on digital interfaces.").

See Commission Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services, 24, COM (2018) 148 final (Mar. 21, 2018) (hereinafter "EU DST Proposal").

[38] Legge 27 dicembre 2019, n. 160, art. 1, para. 37 *bis*(a) (It.).

- "the supplies of goods or services ordered online via the website of the supplier of such goods or services, where the supplier does not act as an intermediary;"[39]
- "the making available of a digital interface where the sole or main purpose of making the interface available is for the entity making it available to supply digital content to users or to supply communication services to users or to supply payment services to users;"[40]
- certain financial services-related activities;[41] and,
- certain activities related to "telematics platforms for the exchange of electricity, gas, environmental certificates and fuels[.]"[42]

Until approximately December 17, 2020, Italy had not released proposed implementing regulations or additional guidance for its DST, complicating compliance issues. However, as described in Section III.C of this report, public sources indicate Italy's DST is predicated on the European Commission's proposal, which provides additional context for the terminology and expected operation of Italy's DST.[43]

Revenue Thresholds

Italy's DST contains two revenue thresholds, a global (or "worldwide") revenue threshold and a national threshold. Businesses, either individually or as a group, are subject to the DST when they generate €750 million or more in global ("worldwide") revenues and €5.5 million or more in revenues in Italy "deriving from the provision of digital services[.]"[44] The Italian DST's two revenue thresholds are defined differently. The DST defines the global revenue threshold by using the term "revenues", without a caveat that those revenues must derive from digital services. By comparison, revenues subject to the national revenue threshold must be both "deriv[ed] from the provision of digital services" and "obtained within the territory of Italy."[45]

Taxable Revenues

Under Italy's DST, taxable revenues include total gross revenues, net of value added tax and other indirect taxes.[46] Revenues are subject to the DST "if the user of a taxable service is located in the territory of the State[.]"[47] The text of the DST provides different definitions for when a user is considered to be located in the territory of Italy based on the type of digital service at issue.

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[39] *Id*. at para. 37 *bis*(b).

[40] *Id*. at para. 37 *bis*(c).

[41] *Id*. at para. 37 *bis*(d).

[42] *Id*. at para. 37 *bis*(f).

[43] *See*, *e.g.*, Paolo Ruggiero & Francesco Cardone, *INSIGHT: Italy Taxes the Digital Economy*, BLOOMBERG TAX (Jan. 29, 2020), https://news.bloombergtax.com/daily-tax-report-international/insight-italy-taxes-the-digital-economy ("According to the explanatory notes of Budget Law for 2020, Italian DST is inspired by the European Commission Directive Proposal of March 21, 2018").

[44] Legge 30 dicembre 2018, n. 145, para. 36 (It.).

[45] *Id.* at para. 36(b).

[46] *Id.* at para. 39.

[47] *Id.* at para. 40.

In the case of targeted advertising, the DST provides that a user is located in the territory of Italy when "the advertising appears on the device of the user in the *moment* in which the device is used in the territory of [Italy] to have access to the digital interface[.]"[48]

In the case of a multi-sided digital interface, the DST provides for two circumstances. If the multi-sided digital interface "facilitates the supplies of goods or services directly between users," then the user is considered to be located in the territory of Italy when "the user uses the device in the territory of the State to have access to the digital interface in that tax period and concludes a corresponding transaction on that interface[.]"[49] If the multi-sided digital interface is "of a type different" than the first circumstance, then the user is considered to be located in the territory of Italy when "the user has an account for the whole or part of the tax period that allows the user to access the digital interface and that account was opened by using a device in the territory of [Italy][.]"[50]

In the case of data transmission, as defined under DST paragraph 37(c), the DST provides that the subject circumstances occur when "the *data generated* from the *user who has been using the device in the territory* of the State to access a digital interface, during that tax period or in the course of a previous tax period, *are transmitted* during that tax period."[51]

Italy's DST further provides that a "device is considered as localized in the territory of the State by reference principally to the Internet Protocol (IP) address of the device used or any other method of geolocation, in compliance with the rules concerning the processing of personal data."[52]

Calculation of DST

Italy's DST provides that "the total amount of taxable revenues is the total amount of revenues resulting from the provision of digital services wherever realized multiplied by the percentage representing the part of such services connected to the territory of the State."[53]

For "the placing on a digital platform of advertising targeted to the users of the platforms,"[54] the percentage is equal to "the proportion of advertisements placed on a digital interface based on data collected about a user who consults such interface while the user is located in the territory of the State[.]"[55]

For "the making available to users of a multi–sided digital interface which allows users to find other users and interact with them and which may also facilitate the provision of underlying

[48] *Id.* at para. 40(a) (emphasis added).
[49] *Id.* at para. 40(b).
[50] *Id.*
[51] *Id.* at para. 40(c) (emphasis added).
[52] Legge 27 dicembre 2019, n. 160, para. 40 *bis* (It.).
[53] *Id.* at para. 40 *ter* (It.).
[54] Legge 30 dicembre 2018, n. 145, para. 37 (It.).
[55] Legge 27 dicembre 2019, n. 160, para. 40 *ter* (It.).

supplies of goods or services directly between users,"[56] the law identifies two circumstances. If "the service concerns a multi-sided digital interface that facilitates the underlying supplies of goods or services directly between users," then the percentage is equal to "the proportion of the operations of delivery of goods or supplies of services for which one of the users of the digital interface is located in the territory of the State[.]"[57] Alternatively, if "the service concerns a multi-sided digital interface of a type different from the types under [the first circumstance]" then the percentage is equal to "the proportion of users having opened an account in the territory of the State that allows the users to access all or part of the available services of the interface and having used such interface during the calendar year concerned[.]"[58]

For "the transmission of data collected about users and generated from users' activities on digital interfaces,"[59] the percentage is equal to "the proportion of users for whom all or part of the data sold were generated or collected during the consultation of a digital interface, when these users were located in the territory of the State."[60]

Italy's DST then calculates "[t]he amount of the tax due . . . by applying a 3% rate on the total amount of taxable revenues generated by the taxpayer during the calendar year."[61]

Payment of DST, Relationship to Other Taxes

The Italian DST requires that taxable persons are required to pay the tax by February 16 for tax liability accrued in the prior calendar year.[62] The first DST payment is expected in February 2021.[63] The DST is "net of value added tax and other indirect taxes."[64]

Estimated Revenue

Public sources estimate that Italy's DST will generate approximately €708 million in tax revenue annually.[65]

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[56] Legge 30 dicembre 2018, n. 145, para. 37 (It.).

[57] Legge 27 dicembre 2019, n. 160, para. 40 *ter* (It.).

[58] *Id.*

[59] Legge 30 dicembre 2018, n. 145, para. 37 (It.).

[60] Legge 27 dicembre 2019, n. 160, para. 40 *ter* (It.).

[61] Legge 30 dicembre 2018, n. 145, para. 41 (It.); Legge 27 dicembre 2019, n. 160, para. 41 (It.).

[62] Legge 27 dicembre 2019, n. 160, art. 1, para. 35 *bis* & 42 (It.).

[63] Legge 27 dicembre 2019, n. 160, para. 42 (It.); *see also* Letter from Minister Luigi Di Maio, Minister of Foreign Affairs and International Cooperation, to Ambassador Robert Lighthizer, U.S. Trade Representative, Aug. 18, 2020 (on file with author).

[64] Legge 30 dicembre 2018, n. 145, para. 39 (It.).

[65] Emanuele Franchi, et al., *Italy's draft 2020 budget calls for unilateral digital services tax*, 1, TAX INSIGHTS FROM INT'L TAX SERVS., PWC (Nov. 14, 2019), https://www.pwc.com/us/en/tax-services/publications/insights/assets/pwc-italy-draft-2020-budget-calls-for-unilateral-digital-services-tax.pdf. Earlier estimates suggested that Italy's DST could generate between €600 million and €700 million in annual revenue. *See* Giuseppe Fonte, *Italy readies 'web tax' in its 2020 budget: sources,* REUTERS (Oct. 14, 2019, 10:40 AM), https://www reuters.com/article/us-internet-tax-italy/italy-readies-web-tax-in-its-2020-budget-sources-idUSKBN1WT1VA; Emanuele Franchi, et al., *Italy's 2019 budget law introduces a digital service tax*, TAX INSIGHTS, PWC (Feb. 19, 2019), https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-italy-2019-budget-law-introduces-a-digital-service-tax.pdf ("During the Italian government and EU Commission negotiations for defining the 2019

Sunset Clause

Article 49 *bis* of Italy's DST provides that the operative statutory provisions will be repealed "from the date of taking effect of the provisions resulting from agreements reached in the international fora on the taxation of the digital economy."[66]

B. COVERED COMPANIES

It is difficult to predict with certainty what companies will be covered by the DST. As described above, the DST applies to companies that, during the previous calendar year, generated €750 million or more in "worldwide" revenues and €5.5 million or more in revenues "deriving from the provision of digital services," as defined by the DST, in Italy. While there are significant ambiguities in the text of Italy's DST, it is possible to estimate what companies will be covered based on a review of publicly available information, including: regulatory filings, corporate annual reports, corporate websites, press articles, and other sources.[67]

In the course of this investigation, 43 companies, or company groups, were identified as likely to be subject to Italy's DST. Of those companies, 27 were U.S. companies, three were Italian, and the remaining 13 were from other countries.[68] Alternatively stated, of those companies identified in the investigation, over 62% of covered companies were U.S. companies, while Italian companies comprised only 6.9% of companies covered by Italy's DST.

By category of covered services, 18 U.S. companies are likely covered under digital advertisement provisions, 14 U.S. companies are likely covered under multi–sided digital interface or intermediation provisions, and 13 U.S. companies are likely covered by data transmission provisions. 15 U.S. companies may fall under more than one category of covered service.

Italian budget, the DST was identified as a revenue raiser (estimated at 150 million EUR for 2019 and 600 million EUR for each of 2020 and 2021)."); Alberto Ballarini, *Il governo studia l'ipotesi di rinviare la digital tax*, DOMANI (Oct. 30, 2020).

[66] Legge 27 dicembre 2019, n. 160, para. 49 *bis* (It.).

[67] USTR's analysis of companies likely covered under Italy's DST was based on a review of publicly available information, including regulatory filings, corporate annual reports, corporate websites, press articles, and other sources. Using these sources, USTR identified which companies would likely meet the DST's criteria, such as revenue thresholds and provision of services meeting the DST's definition of covered services. Where possible, USTR isolated revenue attributable to covered services in Italy. As previously, companies have not been required to publish (or even to collect) data relevant to whether they meet Italy's DST criteria or what tax liability they may incur, and complete information was not available for all companies. Where specific information was not publicly available, USTR used available data to assess whether a company likely met Italy's DST criteria.

[68] One commenter suggested that Italian internet service providers would be subject to the DST. *See* Comments of Schuman Cheese in Opp'n to Action in Regard to Italy's Digital Serv. Tax ("DST") Docket No. USTR-2020-0022, Comment No. USTR-2020-0022-0358 (Jul. 15, 2020). As a preliminary matter, an internet service provider (ISP) is not necessarily a digital service provider. An ISP is defined as a "company that provides [i]nternet connections and services to individuals and organizations". *See Internet service provider*, Encyclopaedia Britannica (Aug. 24, 2017), https://www.britannica.com/technology/Internet-service-provider. Accordingly, an ISP does not necessarily provide services under the Italian DST's definition of covered services. However, USTR's analysis did suggest that at least one of those companies may be subject to the DST as a provider of digital targeted advertising. That company is included among the three Italian companies identified by USTR as possibly subject to Italy's DST.

In comparison, all three Italian companies that may be covered by Italy's DST fall under digital advertisement provisions. The investigation did not identify any Italian company that would meet the Italian DST's covered services and revenue threshold provisions that would fall under either the DST's multi–sided digital interface or intermediation provisions or data transmission provisions.

This indicates that Italy's DST will disproportionately impact U.S. companies. A comment to the investigation also supports this assessment, as that comment identified that "the Italian DST revenue thresholds will have a disproportional effect on U.S. companies."[69]

C. THE EUROPEAN COMMISSION'S DIGITAL SERVICES TAX PROPOSAL

Italy's DST draws from and is similar to the proposal for an EU-wide DST. Accordingly, discussion of the Commission proposal provides context to the analysis of Italy's DST. This discussion addresses the structure of the Commission proposal, as Italy's DST contains a highly similar structure. Likewise, discussion of criticisms of the Commission proposal provides context for the analysis of the adopted Italian DST, as the Italian DST adopts many of the same discriminatory, unfair, and burdensome aspects that have been identified in the Commission proposal.

Public sources indicate that the Italian DST is based on a Commission proposal that would have taxed gross revenues earned by certain companies from supplying certain digital services deemed to be provided in the EU.[70] The Commission introduced the proposal on March 21, 2018.[71] EU members debated the proposal at length, including consideration of various amendments. Under EU law, tax-related legislation at the EU level requires unanimous member state support.[72] Certain EU members, including Ireland, Sweden, and Denmark, opposed the EU-wide DST.[73] After it became clear that the Commission proposal was not going to receive unanimous support, the Italian government adopted its own DST.

The Commission proposal called for a 3 percent tax on revenues generated by covered companies from providing three categories of services provided in the EU. The taxable services were: (i) Internet advertising "targeted at users," (ii) digital "intermediation services" enabling

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[69] Silicon Valley Tax Directors Group, Comment Letter Re: Written Submission in Response to Initiation of Section 301 Investigations of Digital Services Taxes (USTR-2020-0022), Comment No. USTR-2020-0022-0383, 57 (Jul. 15, 2020).

[70] Paolo Ruggiero & Francesco Cardone, *INSIGHT: Italy Taxes the Digital Economy*, BLOOMBERG TAX (Jan. 29, 2020), https://news.bloombergtax.com/daily-tax-report-international/insight-italy-taxes-the-digital-economy ("According to the explanatory notes of Budget Law for 2020, Italian DST is inspired by the European Commission Directive Proposal of March 21, 2018") *citing Commission Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services*, 24, COM (2018) 148 final (Mar. 21, 2018).

[71] *Id.*

[72] *See* European Commission, *Decision making on EU Tax Policy*, EUROPA.EU, https://ec.europa.eu/taxation_customs/taxation/decision-making-eu-tax-policy_en (last visited Dec. 5, 2020).

[73] Jorge Valero, *The EU's digital tax is dead, long line the OECD's plans*, EURACTIV (Mar. 11, 2019), https://www.euractiv.com/section/economy-jobs/news/the-eus-digital-tax-is-dead-long-live-the-oecds-plans/.

users to “find other users and interact with them,” and (iii) the “transmission of data collected about users and generated from such users’ activities on digital interfaces.”[74]

The Italian DST is clearly drawn from the Commission proposal but with certain differences.[75] For example, both the Italian DST and Commission proposal apply nearly identical terminology to describe covered services.[76] The Italian DST and the Commission proposal also contain similar exceptions or exclusions. For instance, the Commission proposal carved out digital interfaces for the supply of “digital content.”[77] Like the Commission proposal, Italy’s DST excludes “the making available of a digital interface where the sole or main purpose of making the interface available is for the entity making it available to supply digital content to users or to supply communication services to users or to supply payment services to users.”[78]

The Commission proposal also contained revenue thresholds. Italy’s revenue thresholds appear to bear some proportional relationship to the Commission proposal thresholds, relative to GDP statistics available in Eurostat.[79] The Commission proposal provided that a company was covered by the tax only if, during the relevant tax year: (i) the total amount of its global annual revenues exceeded €750 million, and (ii) the total amount of taxable revenues earned by the company “within the Union” exceeded €50 million.[80] Like the Italian DST, the EU “within the Union” threshold referred to “taxable revenues.”

Commentators at the time opined that the EU proposal was aimed at, and would be borne primarily by, a few U.S. digital companies. For example:

- Two U.S. commentators noted that “thresholds for applying the DST are very high and would largely embrace [U.S.] firms.”[81] They estimated that Spotify (a Swedish

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[74] *Commission Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services*, 7, 13, 17, 24, COM (2018) 148 final (Mar. 21, 2018).

[75] Emanuele Franchi, et al., *Italy’s draft 2020 budget calls for unilateral digital services tax,* PWC (Nov. 14, 2019), https://www.pwc.com/us/en/services/tax/library/insights/italy-draft-2020-budget-calls-for-unilateral-digital-services-ta.html.

[76] *Compare* Legge 30 dicembre 2018, n. 145, art. 37 (It.) *with* EC DST Proposal, Art. 3.

[77] *Commission Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services*, 24-25, COM (2018) 148 final (Mar. 21, 2018) (defining “digital content” as “data supplied in digital form, such as computer programmes, applications, music, videos, texts, games and any other software, other than the data represented by a digital interface.”).

[77] *Commission Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services*, 24-25, COM (2018) 148 final (Mar. 21, 2018) (defining “digital content” as “data supplied in digital form, such as computer programmes, applications, music, videos, texts, games and any other software, other than the data represented by a digital interface.”).

[78] Legge 27 dicembre 2019, n. 160, art. 1, para. 37 *bis* (It.).

[79] Comparing “GDP and main components (output, expenditure and income” data for Italy and the European Union as available in Eurostat. *See GDP and main components (output, expenditure and income*, EUROSTAT DATA BROWSER (last updated Jul. 12, 2020, 17:00), https://ec.europa.eu/eurostat/databrowser/view/namq_10_gdp/default/table?lang=en.

[80] *Commission Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services*, 10, COM (2018) 148 final (Mar. 21, 2018).

[81] Gary Clyde Hufbauer & Zhiyao Lu, *The European Union's Proposed Digital Services Tax: A De Facto Tariff, Peterson Institute for International Economics*, 5 PIIE (Jun. 2018).

company) would be one of the very few EU companies that would meet the revenue thresholds but that the content carve-out excluded Spotify from the definition of digital intermediation services.[82] This assessment remains concerning as Italy's DST contains highly similar content carve-outs.

- Two European commentators stated that, due to the revenue thresholds, "[t]he tax falls mainly upon [U.S.] multinational firms."[83] The commentators noted that an earlier draft of the measure suggested that the Commission had considered higher thresholds that would have carved out all European firms but decided that these would have "rendered [the tax's] discriminatory effects all too obvious."[84] Even under the final thresholds, however "[o]nly a few European players are affected by the tax."[85] As described in this report, this assessment remains concerning due the discriminatory impact of Italy's DST thresholds.

- Another commentator stated that there was "no legal or economic rationale for [the revenue] thresholds" and that they ensured that "the vast majority of the digital advertising and intermediary businesses within the definition and above the threshold are almost exclusively from" the United States or from China.[86] As described in this report, this assessment remains concerning as it is consistent with this investigation's analysis of companies likely covered by Italy's DST.

A paper circulated within the EC working group developing the proposal identified seven companies that would be affected by the tax—all but one of which were U.S.-based.[87] Further, the one non-U.S. company that the paper mentioned, Spotify, would be covered only as an advertiser—i.e., for the revenues associated with its ad-supported free service—and not with respect to its subscription service, which provides the vast majority of its total revenue.[88] This assessment remains concerning as this investigation identified 27 U.S. companies that may be affected by Italy's DST, compared with three Italian companies that may be affected by Italy's

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[82] *Id.* at 5-6, 8.

[83] Johannes Becker & Joachim Englisch, *EU Digital Services Tax: A Populist and Flawed Proposal*, KLUWER INT'L TAX BLOG (Mar. 16, 2018), http://kluwertaxblog.com/2018/03/16/eu-digital-services-tax-populist-flawed-proposal/.

[84] *Id.*

[85] *Id*.

[86] Hosuk Lee-Makiyama, *The Cost of Fiscal Unilateralism: Potential Retaliation Against the EU Digital Services Tax (DST)*, 7, EUROPEAN CENTRE FOR INTERNATIONAL POLITICAL ECONOMY (May 2018), https://ecipe.org/wp-content/uploads/2018/11/The-Cost-of-fiscal-unilateralism-Potential-retaliation-against-the-EU-Digital-Services-Tax-DST-1.pdf.

[87] European Commission, *Taxation of Digital Activities in the Single Market (Draft)*, 7 (Feb. 26, 2018), https://images.politico.eu/wp-content/uploads/2018/02/taxation-of-digital-economy-2.pdf (citing "Facebook, Google AdWords, Twitter, Instagram, 'free' Spotify, . . . Airbnb, [and] Uber" as companies that would be covered by the tax).

[88] Spotify, *Spotify Technology S.A. Announces Financial Results for First Quarter 2019*, SPOTIFY.COM (Apr. 29, 2019), https://investors.spotify.com/financials/press-release-details/2019/Spotify-Technology-SA-Announces-FinancialResults-for-First-Quarter-2019/default.aspx (showing that, in 2018 and 2019, ad-supported "free" Spotify generated less than 10% of Spotify's total revenues).

[89] Daniel Bunn, *A Summary of Criticisms of the EU Digital Tax*, 7, TAX FOUNDATION (Oct. 2018), https://files.taxfoundation.org/20181022090015/Tax-Foundation-FF618.pdf.

DST. As further discussed in this report, there are no Italian companies that have been identified as subject to Italy's DST in two of the covered services.

Commentators also criticized the structure and rationale of the EU proposal. For example:

- A commentator explained that the proposal was discriminatory because, "[t]ax policy designed to target a single sector or activity is likely to be unfair and have complex consequences. The digital economy is not something that can easily be separated out from the rest of the global economy."[89]

- Another commentator also argued that the EU proposal "squarely conflicts with the permanent establishment concept affirmed in EU member state bilateral tax treaties with the United States."[90]

Because the Italian DST has a similar structure and expected operation, these criticisms remain relevant to Italy's DST. Additionally, adoption of highly similar DST, without accommodation for these fundamental criticisms, suggests that Italy's DST was intended to target covered U.S. companies.

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[89] Daniel Bunn, *A Summary of Criticisms of the EU Digital Tax*, 7, TAX FOUNDATION (Oct. 2018), https://files.taxfoundation.org/20181022090015/Tax-Foundation-FF618.pdf.

[90] Gary Clyde Hufbauer & Zhiyao Lu, *The European Union's Proposed Digital Services Tax: A De Facto Tariff, Peterson Institute for International Economics*, 2 (Jun. 2018).

III. USTR'S FINDINGS REGARDING ITALY'S DST

This section sets out USTR's findings on the question of actionability, *i.e.*, whether Italy's DST is unreasonable or discriminatory and burdens or restricts U.S. commerce. As explained below, the investigation identified discriminatory, unreasonable, and burdensome aspects of Italy's DST.

A. ITALY'S DIGITAL SERVICE TAX DISCRIMINATES AGAINST U.S. COMPANIES

This section addresses how Italy's DST, by its structure and operation, discriminates against U.S. digital companies.

1. The Revenue Thresholds Discriminate Against U.S. Companies

As described in Section II, the DST applies to companies that, during the previous calendar year, generated €750 million or more in "worldwide" revenues and €5.5 million or more in revenues "deriving from the provision of digital services," as defined by the DST, in Italy.

These revenue thresholds serve as a proxy for nationality. This investigation identified 43 companies that would meet Italy's DST revenue thresholds.[91] Of those, 27 companies (or over 62%) were U.S. companies, and only 3 companies (less than 7%) were Italian companies.[92] The disparity between these results indicate that the revenue thresholds have a discriminatory effect. Comments to the investigation and independent sources align with these findings. For example:

- One Italian tax law professor opined that the Italian DST "applies only to large digital undertakings" and so "has the effect of excluding almost all domestic companies, and, therefore, could give rise to an indirect discrimination based on nationality[.]"[93] That comment further assessed that "the [Italian] DST could entail covert discrimination, as the high amounts of revenues that need to be obtained for an entity to qualify as a taxable subject might have the effect of targeting mainly large digital multinational enterprises (MNEs) based in the United States, such as Airbnb, Facebook, Google, Twitter, etc."[94]

- Another comment noted that "Digital Services Taxes often only apply to companies above a minimum revenue threshold. . . . Practically, this protects domestic companies from application of the tax and instead targets multi-nationals and particularly U.S. multi-nationals."[95] This results in "shifting advertising spending away from larger U.S. companies with revenues that exceed the thresholds, to domestic companies with digital advertising revenues that do not meet the thresholds."[96]

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[91] *See* Section II.B.

[92] *See* Section II.B.

[93] Dario Stevanato, *A Critical Review of Italy's Digital Services Tax*, BULLETIN FOR INT'L TAXATION, 6 (Jul. 3, 2020).

[94] *Id*.

[95] Interactive Advertising Bureau, Re: Docket No. USTR-2020-0022, 3, Comment No. USTR-2020-0022-0374 (Jul. 15, 2020).

[96] *Id*.

- In the context of advertising, one comment identified that: "[a]s for Italy, subject to implementing measures, numerous major advertisers (e.g., Gruppo24 Ore, IGP Decaux, Italiaonline, Publiemme) will likely be outside the scope of the DST, and those that may be inside the scope (e.g., Discovery Media, Publitalia, Rai, Cairo Communication) will have minimal tax burdens because digital advertising is a relatively minor part of their businesses."[97]

- Another comment assessed that "[b]y only taxing the revenues of companies that earn more than [an] artificially high amount annually, the laws often exempt domestic companies and effectively target large American technology companies. Through its effects, the revenue thresholds serve as a proxy for nationality – rendering the DST definitively targeted toward, and thus discriminating against, American companies."[98]

Aside from separating large U.S. companies from others, there is nothing substantively meaningful about the DST threshold levels chosen by Italy.[99] Thus, the revenue thresholds chosen by Italy discriminate against U.S. companies.

2. The Selection of Covered Services Under the Italian DST Discriminates Against U.S. Companies

The Italian DST, like the Commission proposal, targets categories of services where U.S. companies are dominant—namely, Internet advertising and "digital interfaces," which covers online marketplaces for goods and services and some subscription services.

Internet Advertising

As described by a comment to the investigation: "[m]any of the world's most popular digital advertising-supported services are provided by companies located in the United States. These companies grew to be world industry leaders due to their innovative offerings, competitive pricing, and early adoption of new technologies and services. As a result of their success in the U.S. and globally, many U.S. companies meet or exceed the revenue thresholds[.]"[100] This description is confirmed by this investigation's assessment of covered companies. As discussed in Section II.B, 18 U.S. companies are likely covered by the Italian DST's digital advertising provisions.[101] In contrast, there are only three Italian companies likely covered under these provisions.[102] This high disparity indicates a discriminatory impact.

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[97] Information Technology Industry Council, Docket No. USTR-2020-0022: Initiation of Section 301 Investigations of Digital Services Taxes, 13, Comment No. USTR-2020-0022-0345 (Jul. 15, 2020).

[98] Americans for Tax Reform Comments on the Initiation of Section 301 Investigations of Digital Services Taxes, Docket No. USTR-2020-0022, 2, Comment No. USTR-2020-0022-0330 (Jul. 14, 2020).

[99] *See*, *e.g.*, Joe Kennedy, *Digital Services Taxes: A Bad Idea Whose Time Should Never Come*, INFORMATION TECHNOLOGY & INNOVATION FOUNDATION (May 13, 2019) ("It is not clear why users suddenly create more value when a company gets beyond this size.").

[100] Interactive Advertising Bureau, Re: Docket No. USTR-2020-0022, 3, Comment No. USTR-2020-0022-0374 (Jul. 15, 2020).

[101] *See supra* Section III.B.

[102] *Id*.

Additionally, because Italy's DST applies "selectively to digital advertising and do[es] not apply to other traditional forms of media and advertising, such as print, television, radio, or out-of-home, these taxes increase the competitiveness of those forms of advertising relative to digital advertising."[103] As a result, one comment identified that DSTs, such as the Italian DST,

> . . . will have a discriminatory impact on U.S. companies vis-à-vis local competitors. For example, some U.S. companies in each DST market will have no choice but to increase their advertising rates to compensate for the costs of complying with the DST. Accordingly, when advertisers or others procuring digital services in each market make decisions as to how best to manage and allocate their budgets, they are likely to redirect significant portions of their spending to local providers that are not subject to the same cost pressures because they are outside the scope of the DST. In-scope U.S. companies will lose out on business to local rivals that do not meet the revenue thresholds or the strict business model definitions in the tax."[104]

Thus, the selection of digital advertising as one of the three narrow services covered by the Italian DST indicates that the Italian DST discriminates against U.S. companies and targets market-leading U.S. companies for special, unfavorable tax treatment.

Digital Interfaces

As described in Section II.B of this report, 14 U.S. companies are likely covered under multi–sided digital interface or intermediation provisions. Only five non-U.S. companies are likely to be covered under this category of covered service. No other country has more than two companies that are likely to be covered under this category of covered service.

Notably, due to the way Italy's DST defines "digital interface" services, it is likely that no Italian company is likely to be covered under this prong of the DST. This occurs because, as in the EU DST proposal, the DST applies only to sales of goods or services where the company operating the digital interface does not itself own or provide the good or service.[105] This distinction has the effect of excluding Italian companies from the scope of the DST while covering their U.S.-based competitors.

Data Transmission

As described in Section II.B of this report, 13 U.S. companies are likely covered by data transmission provisions. Only seven non-U.S. companies are likely to be covered under this category of covered service.[106] No other country has more than two companies that are likely to be covered under this category of covered service. Again, due to the way Italy's DST defines

[103] Interactive Advertising Bureau, Re: Docket No. USTR-2020-0022, 3, Comment No. USTR-2020-0022-0374 (Jul. 15, 2020).

[104] Information Technology Industry Council, Docket No. USTR-2020-0022: Initiation of Section 301 Investigations of Digital Services Taxes, 13, Comment No. USTR-2020-0022-0345 (Jul. 15, 2020).

[105] *Commission Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services*, 17-18, COM (2018) 148 final (Mar. 21, 2018).

[106] *See supra* Section III.B.

covered services involving data transmission, it is likely that no Italian company is likely to be covered under this prong of the DST.

This analysis shows that the narrowly defined digital services covered by Italy's DST are highly likely to affect a significant number of U.S. companies and are unlikely to affect many, if any, Italian companies. This analysis also indicates that covered U.S. companies will be subject special, unfavorable tax treatment when compared to Italian competitors, particular in the provision of advertising services. One comment remarked that, due to the limited scope of covered services under Italy's DST, "there is no non-nationality-based explanation for the selection of covered services and revenue thresholds[.]"[107] Thus, Italy's DST discriminates against covered U.S. companies and targets those market-leading U.S. companies for special, unfavorable tax treatment.

Targeting a Small Number of Digital Companies for Special, Unfavorable Tax Treatment

The DST discriminatorily targets a select group of digital service providers (most of which are U.S. companies), but does not tax companies that provide the same or very similar services in non-digital format. In doing so, Italy's DST is inconsistent with admonishments against targeting the digital economy for different tax treatment. The result is that Italy's DST targets a small number of (mostly U.S.-based) digital companies for special, unfavorable tax treatment.

The OECD has several times cautioned against this discriminatory 'ring-fencing' approach, whereby digital companies are taxed, but non-digital companies that provide the same or similar services are excluded. A 2015 OECD report stated:

> As digital technology is adopted across the economy, segmenting the digital economy is increasingly difficult. In other words, because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy. Attempting to isolate the digital economy as a separate sector would inevitably require *arbitrary lines to be drawn* between what is digital and what is not. As a result, the tax challenges and base erosion and profit shifting (BEPS) concerns raised by the digital economy are better identified and addressed by analysing existing structures adopted by MNEs together with new business models and by focusing on the key features of the digital economy and determining which of those features raise or exacerbate tax challenges or BEPS concerns, and developing approaches to address those challenges or concerns.[108]

A March 2019 OECD public consultation document agreed that "it would be difficult, if not impossible, to 'ring-fence' the digital economy from the rest of the economy for tax purposes

[107] Information Technology Industry Council, Docket No. USTR-2020-0022: Initiation of Section 301 Investigations of Digital Services Taxes, 11, Comment No. USTR-2020-0022-0345 (Jul. 15, 2020).

[108] OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report*, 54, OECD PUBLISHING (2015) (emphasis added).

because of the increasingly pervasive nature of digitalization."[109] Consequently, it recommended changes to international tax rules that do not distinguish between digital and non-digital activities.[110] Another OECD document published subsequently also recognized "that it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes" and therefore focused on a "systematic solution" applicable to all business models.[111]

Other entities have agreed that it is not possible or advisable to "ring-fence" the digital economy. The International Chamber of Commerce endorsed the OECD's statement that it would be "impossible" to "ring-fence the digital economy" in a non-arbitrary way and encouraged a "long-term global solution" to the challenges posed by the digital economy.[112] Even an expert group of the European Commission acknowledged that "there should not be a special tax regime for digital companies. Rather the general rules should be applied or adapted so that 'digital' companies are treated the same way as others."[113]

As described in this report, Italy's DST attempts to "ring-fence" the digital economy through revenue thresholds and a narrow definition of covered taxable services. As anticipated by the 2015 OECD report quoted above, this has resulted in Italy's DST drawing "arbitrary lines."[114] As discussed in Section II.A of this report, aside from separating large U.S. companies from others, there is nothing substantively meaningful about the DST threshold levels chosen by Italy.[115] Likewise, the narrow definition of covered services appears to have been designed in a manner to mainly affect U.S. companies. Thus, the Italian DST's ring-fencing of the digital economy discriminates against U.S. companies by targeting covered U.S. companies with special, unfavorable tax treatment.

B. Italy's DST is Unreasonable Because the DST's Application to Revenue Rather Than Income Is Inconsistent with International Tax Principles

The architecture of the international tax system reflects that corporate income (as defined by domestic law), and not corporate gross revenue, is an appropriate basis for taxation. There are over 3,000 bilateral tax treaties in effect, the majority of which are based on the OECD

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[109] OECD, *Public Consultation Document: Addressing the Tax Challenges of the Digitalisation of the Economy*, 5 OECD PUBLISHING (Feb. 13, 2019), https://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf.

[110] *Id.* at 24-25.

[111] OECD, *Programme of Work to Develop and Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy*, 25, OECD PUBLISHING (May 2019), https://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.pdf.

[112] International Chamber of Commerce (ICC), *Digital Tax Rules Should Be Global and Long-Term in Scope*, ICCWBO.ORG (Mar. 22, 2018), https://iccwbo.org/media-wall/news-speeches/icc-digital-tax-rules-global-long-termscope/.

[113] Expert Group, *Report of the Commission Expert Group on Taxation of the Digital Economy*, 44, EUROPA.EU (May 28, 2014), https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/gen_info/good_governance_matters/digital/report_digital_economy.pdf.

[114] OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report*, 54, OECD PUBLISHING (2015) (emphasis added).

[115] *See*, *e.g.*, Joe Kennedy, *Digital Services Taxes: A Bad Idea Whose Time Should Never Come*, INFORMATION TECHNOLOGY & INNOVATION FOUNDATION (May 13, 2019) ("It is not clear why users suddenly create more value when a company gets beyond this size.").

Model Tax Convention on Income and on Capital and on the UN Model Double Taxation Convention between Developed and Developing Countries.[116] The OECD model treaty provides disciplines on the taxation of "business profits" and other types of income streams, such as dividends, interest, royalties, and capital gains. However, the OECD model treaty makes no provision for taxes on gross revenues.[117] The UN model treaty likewise has disciplines on business profits and numerous other types of income, but has no provision for taxes on gross revenues.[118] The U.S. model tax treaty, as well as scores of bilateral tax treaties to which the United States is a party, including the U.S.-Italy Tax Treaty, have the same scope in this regard.[119] Other sources confirm that prevailing tax policy principles support the taxation of corporate income but not of gross revenue. For example, one comment to the investigation reported that most European countries rejected turnover taxes, i.e., revenue-based taxation, in the 1960s.[120]

Chapter 2 of the OECD publication Addressing the Tax Challenges of the Digital Economy, entitled "Fundamental Principles of Taxation," recognizes two bases for corporate taxation—income and consumption.[121] As described by the OECD, income taxes are "imposed on net profits, that is receipts minus expenses"[122] and that "[i]ncome taxes are levied at the place of source of income.[123] Consumption taxes, on the other hand, "find their taxable event in a transaction, the exchange of goods and services for consideration either at the last point of sale to the final end user (retail sales tax and VAT), or on intermediate transactions between businesses (VAT)[,]"[124] and "are levied at the place of destination (i.e.[,] the importing country)."[125]

The Italian DST is neither an income tax nor a consumption tax. It is not an income tax because the DST is a tax on gross revenue.[126] It is not a consumption tax because it does not find its taxable event in a transaction or in the exchange of services for consideration at the last point of sale to the final end user. Proponents may contend that aspects of the Italian DST, such

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[116] BRIAN J. ARNOLD, AN INTRODUCTION TO TAX TREATIES 1 (2015).

[117] OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, OECD PUBLISHING, art. 7, Dec. 18, 2017 (on business profits); *see id.* arts. 6, 8-21.

[118] *See* United Nations, Model Double Taxation Convention Between Developed and Developing Countries, art. 7, 2017 (setting out disciplines on taxes of business profits); id. arts. 6, 8-21 (covering other types of income).

[119] *See* Dep't Treasury, United States Model Income Tax Convention, art. 2, 2016 (setting out disciplines on "total income, or on elements of income"); *id.* art. 7 (establishing disciplines on taxes of "business profits"); Convention for the avoidance of double taxation with respect to taxes on income and the prevention of fraud or fiscal evasion, with protocol and related exchange of notes, It.-U.S., Aug. 25, 1999, TIAS 09-1216 (entered into force December 16, 2009) (hereinafter U.S.-Italy Tax Treaty).

[120] Daniel Bunn & Elke Asen, Tax Foundation Comments on the Initiation of Section 301 Investigations of Digital Services Taxes, Docket No. USTR_2020-0022, 2, Comment No. USTR-2020-0022-0295 (Jul. 9, 2020); *see also* Daniel Bunn, *A Summary of Criticism of the EU Digital Tax,* TAX FOUNDATION (Oct. 22 2018), https://taxfoundation.org/eu-digital-tax-criticisms/.

[121] OECD, *Fundamental Principles of Taxation*, in ADDRESSING THE TAX CHALLENGES OF THE DIGITAL ECONOMY, 32-47 (OECD PUBLISHING, 2014).

[122] *Id.* at 33.

[123] *Id.* at 32.

[124] OECD, *Fundamental Principles of Taxation* in ADDRESSING THE TAX CHALLENGES OF THE DIGITAL ECONOMY, 32 (OECD PUBLISHING, 2014).

[125] *Id.*

[126] Legge 30 dicembre 2018, n. 145, para. 39 (It.).

as the data transmission provisions, are a tax on intermediate transactions between businesses. However, even that argument fails under the OECD definition, as those transactions between businesses are not levied at the place of destination. As an Italian tax law professor described this aspect of Italy's DST:

> [T]here is no necessary connection between the user's location and the place of consumption, given also that consumption may be lacking entirely, as in the 'business-to-business' (B2B) services envisaged by the [Commission's] DST Proposal, such as advertising, which is not provided to digital users but, rather to the business customers of the digital company, or the transmission of the data of users to other undertakings. The market of destination of taxable digital services might be decoupled from the place of taxation, which corresponds to the country in which the users of the digital interface are located. *From this perspective, the DST is quite dissimilar from an indirect tax on consumption*[.]"[127]

Furthermore, the Italian DST, like the Commission proposal on which it was designed,[128] is structured to avoid the ambit of international tax treaties. One comment illustrated this point in the context of the Commission's DST proposal, stating that:

> The DST is an indirect tax on revenues and its main purpose is to allow Member States to levy *taxation on the profits* of certain businesses, which otherwise would not suffer any source taxation, absent a physical presence therein. In this respect, according to the interpretation provided by the majority of commentators, which we share, the *DST should fall out of the scope of Double Tax Treaties*, insofar as it *is not a tax on income, but on gross revenues* and no deductions are allowed (except for VAT and other similar taxes).[129]

As discussed in Section II.C, Italy's DST is predicated on the Commission's proposal, shares the same operative terms, and is expected to operate in the same manner as the Commission's proposal would have operated. Italy's adopted DST included no adjustment to resolve this issue. This means that Italy's DST is structured to sidestep the existing framework of tax treaties and the prevailing principles of corporate taxation in the same manner as the Commission proposal.

In conclusion, analysis of the Italian DST reveals that the DST's application to revenue rather than income is inconsistent with prevailing principles of corporate taxation. Because Italy's DST is inconsistent with the prevailing principles of corporate taxation, Italy's DST is unreasonable.

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[127] Dario Stevanato, *A Critical Review of Italy's Digital Services Tax*, 6, BULLETIN FOR INT'L TAXATION (Jul. 3, 2020) (emphasis added).

[128] *See* Emanuele Franchi, et al., *Italy's draft 2020 budget calls for unilateral digital services tax,* PWC (Nov. 14, 2019), https://www.pwc.com/us/en/services/tax/library/insights/italy-draft-2020-budget-calls-for-unilateral-digital-services-ta html.

[129] Chiomenti, Notice of Initiation of Investigations, and request for comments [Docket No. USTR-2020-0022] – Comments on the Investigation under Section 301 of the 1974 Trade Act, 3, Comment No. USTR-2020-0022-0351 (Jul. 15, 2020) ("Although it does not contain any specific references, the Italian DST is structured similarly to . . . the European Commission's proposal (201ax 8/0073 (CNS) - Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services).").

1. Italy's DST is Unreasonable Because Taxing Revenue Rather Than Income Fundamentally Alters the Tax Environment for Covered U.S. Companies

The Italian DST's application to revenue rather than income is an unreasonable departure from a key principle of international taxation. Companies create their business models based on existing rules so that they can provide a good or service in a profitable manner. Because Italy's DST applies to revenue rather than income, it creates a fundamental change in the tax environment which, in turn, principally alters the manner in which businesses can operate profitably, if subject businesses can operate profitably at all. This departure from a key principle of international taxation is unreasonable. This section explains the effects of this unreasonable departure.

First, the Italian DST's application to revenue rather than income will materially impact unprofitable companies or companies with a low profit margin, creating adverse consequences that would not arise if the Italian DST was consistent with principles of international corporate taxation. Two comments in this investigation provide examples that illustrate this issue:

- A company that spends $100 and earns $90 is operating at a loss. At a 10% tax on its profits, the normal target of corporate taxation, the company would not be subject to [income] tax. However, if the 10% tax is on the revenues, the $90 in earnings, the tax would be $9 on a company that is already losing money.[130]

- Unlike corporate income taxes, DSTs are levied on revenues rather than profits, not taking into account profitability. Seemingly low tax rates of such turnover taxes can translate into high tax burdens. For instance, a business with $100 in revenue and $85 in costs has a profit margin of $15—or 15 percent. A DST rate of 3 percent means the business is required to pay $3 in revenue tax (3 percent of $100 revenue), corresponding to a profit tax of 20 percent ($3 tax divided by $15 profit). This implies that the corresponding effective profit tax rates vary by profitability, disproportionately harming businesses with lower profit margins.[131]

Alternatively stated, applying the principles of international corporate taxation, companies with a low profit margin, or unprofitable companies, would likely pay little or no income tax. However, because Italy's DST does not follow the principles of international corporate taxation, the DST's application to gross revenues is likely to diminish covered companies' ability to earn a profit. A gross revenue system may also entirely eliminate a company's profit margin or render a company unprofitable. Comments to investigation supported this assessment, stating that:

[130] Americans for Tax Reform Comments on the Initiation of Section 301 Investigations of Digital Services Taxes, 2, Comment No. USTR-2020-0022-0330 (Jul. 14, 2020).

[131] Daniel Bunn & Elke Asen, Tax Foundation Comments on the Initiation of Section 301 Investigations of Digital Services Taxes, 2, Comment No. USTR-2020-0022-0295 (Jul. 9, 2020).

- DSTs "tax revenue instead of profits, which leaves open the possibility that the tax would negatively affect companies who are in a deficit or whose profit margins are narrowing[,]"[132] and,

- "While being in direct conflict with the current rules on profit allocation and nexus requirements, the DSTs also abandon the long-held standard of taxing profits by taxing revenues of the targeted technology companies. This violates the principle that companies should only be taxed on their actual gains from doing business, and leaves open the possibility to being taxed on a loss."[133]

Fundamentally altering the tax environment for covered U.S. companies in a manner with such negative effects, including, but not limited to, taxing companies on a loss, rendering companies unprofitable, or eliminating their profit margin, is unreasonable.

Second, the DST's application to revenue rather than income unreasonably alters the tax environment so as to create an adverse impact on even to profitable companies. This is because a gross revenue tax is equivalent to a much higher rate of income tax. As described by one comment, a "company with a 5 percent profit margin in a country with a 5 percent DST would have the entirety of those profits taxed away, *effectively a 100 percent profits tax. No country taxes profits of domestic companies that heavily*."[134]

Accordingly, the Italian DST's application to revenue rather than income burdens reflects an unreasonable departure from a key principle of international taxation.

2. The DST's Application to Revenue Results in Double Taxation

The Italian DST is inconsistent with the tax policy principle of avoiding double taxation. Avoiding double taxation, i.e., preventing the same income being taxed twice, is a foundational principle of the international tax system.[135] According to the OECD, the "*harmful effects* on the exchange of goods and services and movements of capital, technology and persons" of double taxation "*are so well known* that it is scarcely necessary to stress the importance of removing the

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[132] CompTIA, Docket Number USTR-2020-0022 Initiation of Section 301 Investigations of Digital Service Taxes, 2, Comment No. USTR-2020-0022-0341 (Jul. 15, 2020).

[133] Grover C. Norquist, Americans for Tax Reform Comments on the Initiation of Section 301 Investigations of Digital Services Taxes, Docket No. USTR-2020-0022, 2, Comment No. USTR-2020-0022-0330 (Jul. 11, 2020) (emphasis omitted).

[134] *Id.*; *see also* Daniel Bunn, *The Italian DST Remix,* TAX FOUND. (Jul. 23, 2019), https://taxfoundation.org/italy-digital-tax/ ("One way to think about this analysis is that the Italian proposal uses a formulaic approach to tax digital companies. *This is instead of doing the difficult work* of identifying the value specifically attributable to Italian users of digital services and separating that from the value created by businesses in developing software, building and managing servers, and acquiring advertising customers. The Italian approach is to assume that digital companies have a 12.5 percent profit margin on their services in Italy, and that the entire 12.5 percent profit margin should be taxed in Italy. A problem with such a formulaic approach is that not all businesses fit the formula. The formula does not recognize that some digital companies may effectively be losing money on their Italian user base in some years or that they may be less profitable than the formula suggests.").

[135] *See, e.g.*, OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, OECD PUBLISHING, introduction (Dec. 18, 2017) ("International juridical double taxation can be generally defined as the imposition of comparable taxes in two (or more). States on the same taxpayer in respect of the same subject matter and for identical periods.").

obstacles that double taxation presents[.]"[136] Both tax treaties and model tax treaties alike make clear that one of their primary objectives is the elimination of double taxation between countries.[137]

Because the Italian DST applies to revenue rather than income, the DST will lead to double taxation of the same revenue stream. For example, a company's revenues would be subject to domestic corporate income taxes in addition to Italy's DST. Furthermore, as previously discussed in this report, the structure of the Italian DST makes it likely that the Italian DST will not be within scope of the over 3,000 bilateral tax treaties in effect, the majority of which are based on the OECD Model Tax Convention on Income and on Capital and on the UN Model Double Taxation Convention between Developed and Developing Countries.[138] As described by an Italian tax professor: "[i]n such circumstances, double taxation in the strict sense of the term arises."[139]

Thus, by adding a dimension of taxation that is not aligned with the principles of international corporate taxation, the Italian DST results in double taxation, which is unreasonable.

C. Italy's DST is Unreasonable Because it is Extraterritorial in a Manner that Is Inconsistent with International Tax Principles

In 2018, then-Italian Prime Minister Paolo Gentiloni indicated that Italy would deviate from the principle that companies are not subject to a country's corporate tax regime in the absence of a territorial nexus to that country, as described by a permanent establishment, when stating:

> We cannot accept . . . the idea that the right of *establishment* of companies as regards the giants of the web and platforms *is conceived as in the past*, when the establishment meant paying taxes in the place where the factory had to be. There are platforms that simplify our life and which we do not want to give up for anything in the world, which nevertheless have sensational volumes of business in our countries and perhaps few employees and no chimneys.[140]

The international tax system reflects the principle that companies are not subject to a country's corporate tax regime in the absence of a territorial nexus to that country. This is reflected in international tax treaties, which typically establish that a company need not pay a country's corporate income tax unless it has a "permanent establishment" in that country. For instance:

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[136] OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, OECD PUBLISHING, introduction (Dec. 18, 2017).

[137] *See*, *e.g.*, OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, OECD PUBLISHING, preamble (Dec. 18, 2017); United Nations, Model Double Taxation Convention Between Developed and Developing Countries, preamble, 2017; United States Model Income Tax Convention, preamble, 2016.

[138] BRIAN J. ARNOLD, AN INTRODUCTION TO TAX TREATIES 1 (2015).

[139] Dario Stevanato, *A Critical Review of Italy's Digital Services Tax*, 6, BULLETIN FOR INT'L TAXATION, 6 (Jul. 3, 2020).

[140] *Web tax, everything postponed to 2018, Gentiloni: "Forward even without a European agreement,"* CORCOM (Sep. 29, 2017), https://www.corrierecomunicazioni.it/digital-economy/web-tax-gentiloni-avanti-anche-senza-intesa-generale-europea/ (emphasis added).

- The OECD model tax treaty provides that the profits of an enterprise "shall be taxable" only in the country of which the enterprise is a national "unless the enterprise carries on business in [another country] through a permanent establishment situated therein."[141]

- The UN Model Treaty similarly provides that the profits of an enterprise are taxable in a country only if "the enterprise carries on business in [that country] through a permanent establishment situated therein."[142]

- The U.S. Model Tax Treaty and the U.S.-Italy Tax Treaty both contain similar provisions barring taxation absent a permanent establishment.[143]

Consistent with model treaties, the U.S.-Italy Tax Treaty defines "permanent establishment" as "a fixed place of business in which the business of the enterprise is wholly or partly carried on."[144] The U.S.-Italy Tax Treaty also provides that the term includes, *inter alia*: a place of management, a branch, an office, a factory, a workshop; or a "place of extraction of natural resources."[145] Under the U.S.-Italy Tax Treaty, a "permanent establishment" does not include, *inter alia*, the maintenance of a fixed place of business solely for the purpose of "purchasing goods or merchandise, or for collecting information, for the enterprise" or of "the maintenance of a fixed place of business solely for the purpose of *advertising*, *for the supply of information* . . . or for similar activities which have a preparatory or auxiliary character, for the enterprise."[146] Other sources confirm that this is the general rule in international tax policy.[147]

The international tax system also reflects the principle that, if a foreign company has a permanent establishment in a country, it is subject to that country's tax regime only to a circumscribed extent. The OECD model tax treaty provides that a country may tax a foreign company only on "the profits that are attributable to the permanent establishment" in that

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[141] OECD, Model Tax Convention on Income and on Capital: Condensed Version 2017, art. 7(1).

[142] UN, *Model Double Taxation Convention Between Developed and Developing Countries*, art. 7(1).

[143] *Compare United States Model Income Tax Convention*, art. 7 ("Profits of an enterprise of a Contracting State shall be taxable only in that Contracting State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein.") *with* U.S.-Italy Tax Treaty, art. 7 ("The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment."). Note that the treaty in paragraph 4 of Article 5 may also deem a permanent establishment to exist notwithstanding the general rule in paragraphs 1 and 2 of Article 5 if there is a dependent agent conducting certain activities on behalf of the foreign enterprise.

[144] U.S.-Italy Tax Treaty, art. 5; *see also* OECD, Model Tax Convention on Income and on Capital: Condensed Version 2017, art. 5(1); UN, Model Double Taxation Convention Between Developed and Developing Countries, art. 5(1); United States Model Income Tax Convention, art. 5(1).

[145] U.S.-Italy Tax Treaty, art. 5; OECD, Model Tax Convention on Income and on Capital: Condensed Version 2017, art. 5(2); UN, Model Double Taxation Convention Between Developed and Developing Countries, art. 5(2); United States Model Income Tax Convention, art. 5(2).

[146] U.S.-Italy Tax Treaty, art. 5 (emphasis added); OECD, Model Tax Convention on Income and on Capital: Condensed Version 2017, art. 5(4); UN, Model Double Taxation Convention Between Developed and Developing Countries, art. 5(4); United States Model Income Tax Convention, art. 5(4).

[147] *See, e.g.*, OECD, *Inclusive Framework on Base Erosion and Profit Shifting, Action 7: Permanent establishment status*, OECD (2019), https://www.oecd.org/tax/beps/beps-actions/action7/.

country.[148] The profits attributable to the permanent establishment "are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions."[149] The U.S. model tax treaty and the U.S.-Italy Tax Treaty both contain substantially the same provisions.[150] The UN model treaty is substantially similar: it provides that a country may tax only so much profit as is attributable to the permanent establishment in that country or to other business activities (including sales of goods) carried out in the country that are of "the same or similar kind" as those carried out by the permanent establishment.[151]

Italy's DST deviates from principle that companies are not subject to a country's corporate tax regime in the absence of a territorial nexus to that country. As discussed in this report, Italy's adopted DST unambiguously applies to non-residents without a permanent establishment in Italy.[152] For example, paragraph 43 of the DST states, in relevant part, that:

> *Non-resident taxable persons, without a permanent establishment within the territory of the State,* established in a State other than a Member State of the European Union or a State of the European Economic Area with which Italy has not concluded an agreement on administrative cooperation to fight against tax evasion and tax fraud and an agreement for mutual assistance for the recovery of tax claims, *shall* appoint a tax representative to comply with their obligation to declare and *pay the digital services tax*.[153]

A comment in the investigation supports this assessment, stating that "[t]he Italian DST legislation does not require the physical presence of the relevant service provider in Italy" because DST charges "are allocated on the basis of the localization of users"—not permanent establishments.[154]

As such, the Italian DST is unconnected to a permanent establishment and unconnected to revenues related to such a permanent establishment. Because the Italian DST's application to revenues unconnected from a companies' presence in Italy is inconsistent with prevailing international tax principles, Italy's DST is unreasonable.

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[148] OECD, Model Tax Convention on Income and on Capital: Condensed Version 2017, art. 7(1).

[149] *Id.* at art. 7(2).

[150] United States Model Income Tax Convention, art. 7; U.S.-Italy Tax Treaty, art. 7 ("[W]here an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment and other associated enterprises.").

[151] UN, Model Double Taxation Convention Between Developed and Developing Countries, art. 7(1)-(3).

[152] Legge 30 dicembre 2018, n. 145, para. 43 (It.).

[153] Legge 27 dicembre 2019, n. 160, para. 43 (It.) (emphasis added).

[154] Chiomenti, Notice of Initiation of Investigations, and request for comments [Docket No. USTR-2020-0022] – Comments on the Investigation under Section 301 of the 1974 Trade Act, 8, Comment No. USTR-2020-0022-0351 (Jul. 15, 2020).

D. ITALY'S DST BURDENS OR RESTRICTS U.S. COMMERCE

1. DST Liability Is a Burden on U.S. Companies

Italy's DST burdens affected U.S. companies. As described in Section II.B of this report, a significant number of U.S. companies are expected to be affected by the Italian DST. Likewise, as described in this report, Italy's DST will impose a significant tax liability on covered companies, generating as much as €708 million in tax revenue annually.[155] Thus, Italy's DST burdens or restricts U.S. commerce.

2. The Italian DST's User Location Provision Is a Burden for Covered U.S. Companies

The Italian DST's reliance on user location is a burden to covered U.S. companies. In order to establish a link between taxable revenues and Italy's taxable jurisdiction, Italy's DST's relies on user location (instead of the location of the company providing the service).[156] Italy's DST provides that a user's "device is considered as localized in the territory of the State by reference principally to the Internet Protocol (IP) address of the device used or any other method of geolocation, in compliance with the rules concerning the processing of personal data."[157] Reliance on user location makes the DST difficult to calculate and administer, which are burdens on covered U.S. companies. As described by an Italian tax law professor:

> On this point, the Italian DST . . . faces significant criticism. First, users can freely move among countries, as can their electronic devices. Second, geo-localization services and IP addresses might be deliberately shielded or deactivated such that the user cannot be tracked by the interface owners. Accordingly, one of the key elements required for the Italian DST to apply could prove to be ineffective, thereby *making the payment of the tax a task very difficult to manage by digital undertakings* and difficult to enforce by the tax authorities, possibly leading to double counting and taxation.[158]

A comment in this investigation also identified this problem, adding that "legislation imposing DSTs often cites IP addresses as a tool to identify location of the provision of service" but that "[t]his analysis is difficult when users use virtual private networks (VPNs) to mask location[.]"[159] This is illustrative of Italian DST burdens. Thus, the Italian DST's reliance on user location is a burden.

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[155] Emanuele Franchi, et al., *Italy's draft 2020 budget calls for unilateral digital services tax*, 1, TAX INSIGHTS FROM INT'L TAX SERVS., PWC (Nov. 14, 2019), https://www.pwc.com/us/en/tax-services/publications/insights/assets/pwc-italy-draft-2020-budget-calls-for-unilateral-digital-services-tax.pdf.

[156] Dario Stevanato, *A Critical Review of Italy's Digital Services Tax*, 6, BULLETIN FOR INT'L TAXATION (Jul. 3, 2020).

[157] Legge 27 dicembre 2019, n. 160, para. 40 *bis* (It.).

[158] Dario Stevanato, *A Critical Review of Italy's Digital Services Tax*, 6, BULLETIN FOR INT'L TAXATION (Jul. 3, 2020).

[159] Comments of Computer & Communications Industry Association (CCIA), 3-4, USTR-2020-0022-0329 (Jul. 14, 2020).

3. Italy's Lack of DST Regulations and Guidance Is a Burden

Italy's lack of implementing regulations and guidance has been a burden in several respects.

First, the operative form of Italy's DST was adopted on December 27, 2019, and the tax took effect and began accruing liability as of January 1, 2020.[160] This provided for no adequate period of adjustment or grace period for affected U.S. companies to comply with the tax. As a point of comparison, an OECD report, *Mechanisms for the Effective Collection of VAT/GST When the Supplier is not Located in the Jurisdiction of Taxation*, recommends that, for the imposition of new, extraterritorial value-added taxes, "[a] minimum of six months lead time" between entry into force and application is considered to be a "reasonable period" to allow a "smooth and proper operational process change."[161] As a substantively new tax, Italy's DST would require a period of adjustment at least as long as a period necessary for a VAT or GST change, which would operate within an existing, understood framework. Based on the date of adoption, there were only five days before liability under Italy's DST obligated. Moreover, implementing guidance and regulations were not available either at the time that the DST was adopted or by the date that DST liability obligated. Because essential guidance was unavailable, comments in this investigation described the Italian DST as retroactive, stating that "the Italian measure will apply *retroactively* to January 1, 2020, *once technical details are released*."[162] A comment in this investigation also noted this "presents a huge administrative and compliance burden, and limits the ability of affected companies to effectively plan and prepare for a levy."[163] In this sense, the Italian DST is, for all intents and purposes, retroactive.

Second, Italian tax authorities did not release proposed implementing regulations or guidance until approximately December 17, 2020. These proposed regulations are scheduled for a comment period that expires on December 31, 2020.[164] This means that companies will have been operating in an uncertain environment for almost the entirety of the first calendar year of the DST. Absent such regulations or guidance, key details, such as what companies were be affected by the tax and how the tax was be applied, were unknown or ambiguous.[165] As Italy's proposed regulations are not final and the comment period for these regulations closes on December 31, 2020, uncertainty will remain until Italy's regulations are finalized.

One example of how the lack of implementing regulations during calendar year 2020 created burdensome compliance complexities is the issue of whether the Italian DST would be

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[160] Legge 27 dicembre 2019, n. 160, para. 47 (It.).

[161] OECD, MECHANISM FOR THE EFFECTIVE COLLECTION OF VAT/GST WHERE THE SUPPLIER IS NOT LOCATED IN THE JURISDICTION OF TAXATION, 51 (2017), https://www.oecd.org/tax/tax-policy/mechanisms-for-the-effective-collection-of-VAT-GST.pdf https://www.oecd.org/tax/tax-policy/mechanisms-for-the-effectivecollection-of-VAT-GST.pdf.

[162] Information Technology Industry Council, Docket No. USTR-2020-0022: Initiation of Section 301 Investigations of Digital Services Taxes, 15-16, Comment No. USTR-2020-0022-0345 (Jul. 15, 2020) (emphasis added).

[163] Comments of Engine Advocacy, Docket No. USTR-2020-0022, 5, Comment No. USTR-2020-0022-0381 (Jul. 16, 2020).

[164] *Consultazione pubblica sullo schema di provvedimento relativo all'imposta sui servizi digitali,* MINISTERO DELL'ECONOMIA E DELLE FINANZE (last visited Dec. 20, 2020), https://www.agenziaentrate.gov.it/portale/ consultazione-pubblica-imposta-sui-servizi-digitali.

[165] *See* Integration to Netcomm's comments on the Tax on Digital Services, Budget Law 2020, Comment No. USTR-2020-0022-0340 (Jul. 15, 2020).

deductible from Italy's corporate income tax. As explained by one accounting firm: "[t]he Budget Law 2020 does not specify whether the DST is (i) deductible against Italian Corporate Income Tax; or (ii) creditable against other local taxes."[166] This meant that the "Italian DST could lead to possible cases of double taxation where profits deriving from revenues subject to Italian DST are also subject to corporate income tax."[167] Observers also have identified that "[c]onsidering that Italian DST seems to qualify as an indirect tax, it should not be covered by the double tax treaties concluded by Italy but, according to Italian tax rules, it should be deductible from Italian corporate income tax."[168] If the Italian DST is deductible against Italy's corporate income tax, then Italy's DST may raise further discrimination concerns. As described by a comment:

> [A] domestic company that pays a DST will generally be able to deduct the payment against its domestic corporate income taxes. This will increase the cost advantage for domestic firms, as foreign companies will not be able to offset their tax payments: they will not have a domestic income tax bill from which to deduct DST payments, and they will not be able to deduct the DST payments from their home country income taxes.[169]

Absent guidance on this point, companies incur a burden in attempting to comply with the DST amid complexity. This may also result in financial burdens, if companies interpreted the DST in a manner inconsistent with later Italian regulations.

Third, Italy's DST imposes administrative burdens on covered U.S. companies. One such burden is the re-engineering systems to comply with the Italian DST. Companies were not previously required to—and did not—categorize users as being in Italy or not in Italy for the purposes of determining taxable revenue. This issue was addressed in a comment in this investigation, which stated that "[w]hile firms have access to limited data provided by users, firms do not collect and/or retain this data for the purpose of tax compliance and the current data held is likely insufficient to make accurate calculations under the law."[170] Accordingly, covered U.S. companies must re-engineer their systems in order to comply with Italian DST calculation requirements. This compliance is made more difficult "when users use virtual private networks (VPNs) to mask location, as legislation imposing DSTs often cites IP addresses as a tool to identify location of the provision of service."[171] This precisely describes an issue raised by the Italian DST. In the absence throughout most of calendar year 2020 of implementing regulations or guidance to explain how companies should address these complicated, yet fundamental, issues, companies incurred additional burdens.

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[166] *Italy – Digital Services Tax,* BDO GLOBAL (last visited Dec. 8, 2020), https://www.bdo.global/en-gb/microsites/digital-services-taxation/countries-cit-map/italy-digital-services-tax.
[167] Paolo Ruggiero & Francesco Cardone, *INSIGHT: Italy Taxes the Digital Economy*, BLOOMBERG TAX (Jan. 29, 2020), https://news.bloombergtax.com/daily-tax-report-international/insight-italy-taxes-the-digital-economy.
[168] *Id.*; *see also* Silicon Valley Tax Directors Group, Comment Letter Re: Written Submission in Response to Initiation of Section 301 Investigations of Digital Services Taxes (USTR-2020-0022), 58 (Jul. 15, 2020).
[169] Information Technology Industry Council, Docket No. USTR-2020-0022: Initiation of Section 301 Investigations of Digital Services Taxes, 14, Comment No. USTR-2020-0022-0345 (Jul. 15, 2020).
[170] Comments of Computer & Communications Industry Association (CCIA), 3-4, USTR-2020-0022-0329 (Jul. 14, 2020).
[171] *Id.* at 4.

In sum, the lack of implementing regulations or guidance for Italy's DST has raised myriad burdens for affected U.S. companies. Furthermore, issues arising from implementing regulations or guidance may warrant further investigation under Section 301 of the Trade Act.

IV. CONCLUSION

The results of this investigation indicate that:

(1) 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.

(2) Italy's DST is unreasonable because it is inconsistent with principles of international taxation; including due to application to revenue rather than income and extraterritoriality.

(3) Italy's DST burdens or restricts U.S. commerce.

ANNEX 1: ITALY'S DIGITAL SERVICE TAX (ENGLISH TRANSLATION)

Unofficial translation

CONSOLIDATED TEXT
Article 1 of Law No 145 of 30 December 2018
(as amended by Article 1, paragraph 678, of Law No 160 of 27 December 2019)

35. It is established the tax on digital services.

35.bis. The tax applies to revenues deriving from the provision of the services listed in paragraph 37, obtained by the taxable persons referred to in paragraph 36, during the calendar year.

36. Taxable persons are the entities engaged in a business that, individually or on a group level, ***in the calendar year preceding the year referred to in paragraph 35.bis***, generate jointly:

a) a total amount of worldwide revenues no less than EUR 750.000.000;

b) a total amount of revenues deriving from digital services, listed in paragraph 37, obtained within the territory of Italy no less than EUR 5.500.000.

37. The tax applies to revenues deriving from the provision of the following services:

a) the placing on a digital platform of targeted advertising to the users of the platforms;

b) the making available to users of a multi – sided digital interface which allows users to find users and interact with them and which may also facilitate the provision of underlying supplies of goods or services directly between users.

c) the transmission of data collected about users and generated from users' activities on digital interfaces.

37.bis. The following shall not be regarded as digital services listed in paragraph 37:

a) the provision of underlying supplies of goods or services directly between users, as part of a digital intermediation service;
b) the provision of underlying supplies of goods or services which are contracted online via the website of the supplier of such goods or services, where the supplier does not act as an intermediary;

c) the making available of a digital interface where the sole or main purpose of making the interface available is for the entity making it available to supply digital content to users or to supply communication services to users or to supply payment services to users;

d) the making available of a digital interface which is used to manage:

1) the interbank settlement systems provided for by the consolidated act referred to in Legislative Decree No 385 of 1 September 1993, or systems for settlement or delivery of financial instruments;

2) the trading platforms or trading systems of systematic internalisers pursuant to Article 1, paragraph 5-octies, letter c) of the consolidated act referred to in Legislative Decree No 58 of 24 February 1998;

3) advisory activities in participatory investments and, if they facilitate the granting of loans, the intermediation services in participatory funding;

4) the wholesale trading venues referred to in Article 61, paragraph 1, letter e) of the consolidated act referred to in Legislative Decree No 58 of 24 February 1998;

5) the central counterparties referred to in Article 1, paragraph 1, letter w-quinquies) of the consolidated act referred to in Legislative Decree No 58 of 24 February 1998;

6) the central depositories referred to in Article 1, paragraph 1, letter w-septies) of the consolidated act referred to in Legislative Decree No 58 of 24 February 1998;

7) the other connection systems whose activity is subject to authorization and execution of performance of services is subject to supervision of a regulatory authority in order to ensure the safety, quality and transparency of transactions involving financial instruments, savings products or other financial assets;

e) the transmission of data by the entities providing the services mentioned in letter d);

f) the carrying out of the activities for organising and managing telematics platforms for the exchange of electricity, gas, environmental certificates and fuels, as well as the transmission of the related data collected there and any other related activity.

38. The revenues deriving from the provisions of services listed in paragraph 37 to entities that, in accordance with article 2359 of the Civil Code, are controlled, control or are under the control of the same entity, are not subject to the tax.

39. The taxable revenues shall include total gross revenues, net of value added tax and other indirect taxes.

39.bis. Charges paid for the provision of the services listed in paragraph 37, letter b) include the totality of fees paid by users of a multi–sided digital interface, with the exception of those paid as consideration for the sale of goods or provision of services which, on an economic level, constitute operations that are independent of access to and use of the taxable service.

39.ter. Fees for the making available of a digital interface that facilitates the sale of products subject to excise duty pursuant to Article 1(1) of Council Directive 2008/118/EC of 16

December 2008 concerning the general arrangements for excise duty and repealing Directive 92/12/EEC, shall not be taken into account when they have a direct and indivisible link with the volume or value of such sales.

40. The tax period coincides with the calendar year. Revenues are considered subject to the tax in a tax period if the user of a taxable service is located in the territory of the State in such period. A user is considered located in the territory of the State when:

a) in the case of a service listed under paragraph 37, letter a), the advertising appears on the device of the user in the moment in which it is used in the territory of the State, in that tax period, to have access to the digital interface;

b) in the case of a service listed under paragraph 37, letter b), if:

1) the service concerns the making available to users of a multi – sided digital interface which facilitates the provision of underlying supplies of goods or services directly between users, the user uses the device in the territory of the State in that tax period to have access to the digital interface and conclude a corresponding transaction on that interface in that tax period;

2) the service concerns the making available of a multi – sided digital interface of a type different from the types under number 1), the user has an account for the whole or part of the tax period that allows the user to have access to the digital interface and that account was opened by using a device in the territory of the State;

c) in the case of a service listed under paragraph 37, letter c), the data generated from the user that used the device in the territory of the State to have access to a digital interface, during that tax period or in the course of a previous tax period, are transmitted during that tax period.

40.bis. The device is considered localized in the territory of the State by making reference principally to the Internet Protocol (IP) address of the device used or any other method of geolocation, in compliance with the rules concerning the processing of personal data.

40.ter. When a taxable service listed in paragraph 37 is provided in the territory of the State during a calendar year under paragraph 40, the total amount of taxable revenues is the total amount of revenues resulting from the provision of digital services wherever realized multiplied by the percentage representing the part of such services connected to the territory of the State. This percentage is equal to:

a) for the services listed in paragraph 37, letter a), the proportion of advertisements placed on a digital interface based on data collected about a user who consults such interface while the user is located in the territory of the State;

b) for the services listed in paragraph 37, letter b), if:

1) the service involves a multi-sided digital interfaces that facilitates the provision of underlying supplies of goods or services directly between users, the proportion of the

transactions for supplies of goods or services for which one of the users of the digital interface is located in the territory of the State;

2) the service concerns the making available of a multi-sided digital interface of a type different from the types under number 1), the proportion of users having opened an account in the territory of the State that allows the users to have access to all or part of the services available on the interface and having used such interface during the calendar year concerned;

c) for the services listed in paragraph 37, letter c), the proportion of users for whom all or part of the data sold were generated or collected during the consultation of a digital interface, when these users were located in the territory of the State.

41. The due tax amount is calculated by applying a 3% tax rate on the total amount of taxable revenues generated by the taxpayer ***during the calendar year***.

42. Taxable persons are required to pay the tax by 16 February of the calendar year following the year referred to in paragraph 35.bis. The same taxable persons are required to present the annual return of the amount of taxable services provided by 31 March of the same year. For the companies belonging to the same group, a single group company is appointed to fulfill the obligations deriving from the provisions concerning the digital services tax.

43. Non-resident taxable persons, without a permanent establishment within the territory of the State and without an identification number for value added tax purpose, that meet in the tax period the requirements listed in paragraph 36, must request the Revenue Agency an identification number for the purpose of the digital services tax. The request is made according to the modalities provided for in the Decision of the Director of the Revenue Agency under paragraph 46. ***Non-resident taxable persons, without a permanent establishment within the territory of the State, established in a State other than a Member State of the European Union or of the European Economic Area with which Italy has not concluded an agreement on administrative cooperation to fight against tax evasion and tax fraud and an agreement for mutual assistance for the recovery of tax claims, must appoint a tax representative to fulfill their obligation to declare and pay the digital services tax.*** The entities resident in the territory of the State that belong to the same group of the taxpayer mentioned in the first part of the present paragraph are jointly and severally liable with the taxpayer for the obligations deriving from the provision on the digital services tax.

44. For audit, sanction and payment purposes and for the purpose of disputes related to the digital services tax, the provisions of value added tax apply, where compatible.

44.bis. Taxable persons shall keep separate accounts to record on a monthly basis information on the revenues from taxable services, as well as the monthly quantitative elements relevant to the calculation of the proportions referred to in paragraph 40.ter. The information on the sums received monthly shall indicate, where necessary, the amount collected in a currency other than the euro and the amount converted into euro. The amounts received in a currency other than the euro shall be converted by applying the latest exchange rate published in the

Official Journal of the European Union, known on the first day of the month during which the sums are received.

46. The implementing measures of the provision related to the digital services tax are adopted by mean of one or more Decisions of the Director of the Revenue Agency.

47. The provisions concerning the digital services tax shall apply from 1 January 2020.

48. No new or further burdens on the public finances shall arise from the implementation of the regulations contained in paragraphs 35 to 50. The administrations concerned shall provide for the obligations deriving from the digital services tax by mean of the human, instrumental and financial resources at their disposal under the current provisions.

49. The Minister for the Economy and Finance presents to the Parliament an annual report on the implementation status and the economic and fact - finding results from the provisions on the digital services tax. In the Update to the Economic and Financial Document, the Minister for the Economy and Finance presents a report on the implementation of the provisions on the digital services tax, also for the purpose of its financial effects.

49.bis. Paragraphs 35 to 49 are repealed from the date of taking effect of the provisions resulting from agreements reached in international fora on the taxation of the digital economy.

50. Paragraphs from 1011 to 1019 of Article 1 of the Law 27.12.2017 n. 205 are repealed.

ANNEX 2: LETTER FROM AMBASSADOR ROBERT LIGHTHIZER TO THE GOVERNMENT OF ITALY

THE UNITED STATES TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON

June 2, 2020

Minister Luigi Di Maio
Ministry of Foreign Affairs and International Cooperation
Rome, Italy

Dear Minister Di Maio:

I am writing to inform you that, in accordance with Chapter 1 of Title III of the Trade Act of 1974 (known as Section 301), I have determined to initiate a Section 301 investigation of the digital services tax (DST) adopted by Italy. In particular, the investigation addresses a 3% tax on revenues from targeted advertising and digital interface services.

The investigation will initially consider several problematic aspects of DSTs: (1) whether the tax amounts to *de facto* discrimination against U.S. companies; (2) whether the tax has retroactive elements; and (3) whether the tax diverges from norms reflected in the U.S. tax system and the international tax system due to, *e.g.*, possible extraterritorial application, or a purpose of penalizing certain technology companies for their commercial success. Depending on the course of the investigation, other aspects and features of the measure might also be included.

In accordance with Section 303 of the Trade Act of 1974, I hereby request consultations with the Government of Italy regarding this matter. These issues are of great concern to the Government of the United States. I look forward to working with you or another appropriate official in a cooperative manner to resolve this matter.

Sincerely yours,

Robert Lighthizer

cc: Roberto Gualtieri, Minister of Economy and Finance