Digital Services Taxes: A Bad Idea Whose Time Should Never Come

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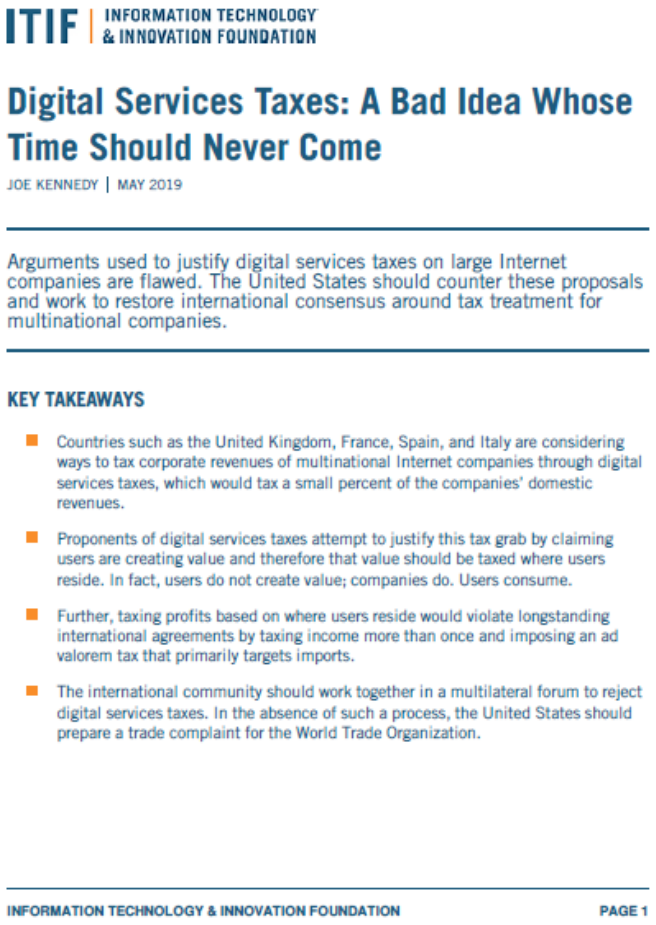
Why Write a Report on Digital Services Taxes?

- Several countries are in the process of enacting DSTs.
- DSTs substantially change the rules for taxing multinationals.
- Proliferation of DSTs would hamper efforts to stabilize international tax rules.



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JOE KENNEDY | MAY 2019

Arguments used to justify digital services taxes on large Internet companies are flawed. The United States should counter these proposals and work to restore international consensus around tax treatment for multinational companies.

KEY TAKEAWAYS

- Countries such as the United Kingdom, France, Spain, and Italy are considering ways to tax corporate revenues of multinational Internet companies through digital services taxes, which would tax a small percent of the companies' domestic revenues.
- Proponents of digital services taxes attempt to justify this tax grab by claiming users are creating value and therefore that value should be taxed where users reside. In fact, users do not create value; companies do. Users consume.
- Further, taxing profits based on where users reside would violate longstanding international agreements by taxing income more than once and imposing an ad valorem tax that primarily targets imports.
- The international community should work together in a multilateral forum to reject digital services taxes. In the absence of such a process, the United States should prepare a trade complaint for the World Trade Organization.

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Outline

- How does the international system for taxing multinational corporations work?
- What is a digital services tax?
- What are the arguments for it?
- Are these arguments valid?

International Corporate Tax Law

- Consists of international agreements and thousands of bilateral treaties.
- Key principles
  - All profits should be taxed somewhere, but only once.
  - Profits are taxed in the country where value is created.
  - The sale of a product does not create value.
  - Companies must have a permanent establishment before they can be taxed.
  - Arms-length standard to evaluate transactions within a firm.

Trends in International Corporate Tax

- It is getting easier for companies to locate productive activity in one country and export worldwide.
  - Lower transportation costs
  - Lower communication costs
  - Trade agreements
  - Rapid growth in services
  - Digitalization
- This results in a fear of tax competition and base erosion.

OECD Base Erosion and Profit Shifting Program (BEPS)

- Over 150 nations
- 15 broad action items agreed to
- Dealt with worst cases of tax avoidance and manipulation of rules
  - Transfer pricing agreements have to reflect economic reality
  - Enhanced information sharing
- Looking at broader issues as well

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Why DSTs?

- Part of a broader effort to direct more tax revenue to destination countries.
- Main argument is that for certain businesses, especially digital firms, a great deal of value is created by users, not the company.
- Therefore, the profits should be taxed where the user lives, not where the corporation operates.

History

- European Commission failed in an effort to enact a DST across the EU.
- Individual countries are now pursuing domestic efforts.

France	South Korea
United Kingdom	Australia
Spain	Chile
Italy	

What is a DST?

- Tax of 2-3 percent on revenues rather than profits.
- High thresholds to avoid hitting local companies.
  - EC plan: €750 million in worldwide revenue and €50 million in EU revenue.

What is a DST? (continued)

- Narrow group of businesses:
  - Social media platforms
  - Internet search engines
  - Online markets (Uber, Amazon)
- Narrow group of revenues:
  - Sale of targeted advertising
  - Sale of user data
  - Commissions for online market platforms

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Arguments for a DST

- Digital companies are under-taxed.
- Users create much of the value and so create nexus.
  - User-generated content
  - User data
  - Patronage of Internet platforms

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Responses

- The average taxation of Internet companies is comparable to that of other industries.
- Large Internet firms are not unique.
  - Digitalization is affecting almost all companies.
  - OECD warned against trying to ring fence the digital economy.

User-Generated Content Does Not Create Value

- Most users post very little.
- Most of what is posted is of little interest to most users.
- Users with large followings already are compensated in the form of fame, influence, and sometimes money.
- The transaction is best understood as allowing free access to the platform in exchange for data. Donated services are seldom taxed.

User Data Does Not Create Value

- With the Internet of Things, more companies collect user data to improve their products and build relationships with users.
- Best understood as a normal sale of valuable services for data.
  - Evidence shows most users prefer paying in data rather than money.
- User data often has little value outside of the context in which it is collected.
- User data is not value added, it is payment for services.

Use of Internet Platforms Does Not Create Value

- The value of Uber and Amazon is in the software they provide, the customer service, and the business model (set price, set route, peer rating, phone-based).
- Users are drawn to the platform, not to other users.
- Why only tax sites that offer multiple vendors?

Other Objections

- May violate tax treaties
- Probably violates trade agreements
- Is aimed at large, foreign companies
- Amounts to a calculated revenue grab
- Complicates ongoing OECD/G7 negotiations
- Could use a VAT instead

Thank You!

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