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.
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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- What Is a Digital Services Tax?
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- Are These Arguments Valid?
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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