TAXING TECH

Digital services taxes take shape in the shadow of the pandemic

Rebecca Christie

When European Union leaders took aim at the global pandemic last year, they knew they would need a bigger budget. To help pay for it, they will look toward bigger companies: the world's technology giants.

EU leaders agreed in principle to introduce a digital levy, with details to be put forward in mid-2021. While it won't be the largest source of revenue for the pandemic budget, it could be a big step forward in how European countries tax corporations. The plan adds to a long-standing push to reevaluate how the tech titans pay taxes and address how countries around the world can claim their fair share of revenue they help to generate.

If successful, new tax regimes could make it easier for countries to collect revenue generated within their borders and reduce public ire toward the outsize successes of American companies like Amazon, Facebook, Apple, and Google parent Alphabet. If botched, a patchwork of digital-specific taxes could spark trade wars and bog down innovation without generating enough money to matter.

National and regional momentum is building on top of a 137-nation push from the Organisation for Economic Co-operation and Development (OECD). But the global process, which goes beyond digital to address a wider range of corporate tax concerns, takes time and was set aside when COVID-19 became top priority. As a result, some countries have chosen to enact digital services taxes individually, taking a stand and drawing a backlash. The United States has opened trade investigations against countries from France to Indonesia, claiming such taxes unfairly single out American companies.

French President Emmanuel Macron has said that forcing tech companies to pay more tax is a matter of social justice, and France has been at the forefront of efforts to front-run as well as encourage the broader OECD process. The United States has pushed back, saying such one-off moves undermine the worldwide talks. The two countries stepped back from the brink of a trade war in January—but tensions remain high, even though the amount of money at stake is small.

"With only a few billions of shifting revenue at stake, you could sort out one of the most disputed topics, which would be worth engaging on this," said Pascal Saint-Amans, director of the OECD's Center for Tax Policy and Administration. "Absent

a multilateral solution, there is a serious risk of unilateral measures being taken, and these measures may trigger sanctions or trade tensions."

A question of fairness

The precedents that would be set by changing the global tax rules, particularly if there is not a worldwide playbook, have made corporations take notice. They argue that a stable and reliable system should be the priority, rather than piling on compliance costs and the political battles that would inevitably follow. "We accept that may mean we have to pay more tax and pay it in different places under a new framework," said Facebook CEO Mark Zuckerberg at last year's Munich Security Conference.

The OECD makes the case that changing how digital services are taxed is a question of fairness, not just revenue. Prior debates about taxing e-commerce have focused on how to apply sales taxes. But such models do not capture the full range of profits earned by companies that offer free services in exchange for information.

There is "a growing frustration" with companies that make profits in countries where they don't have a physical presence, said Saint-Amans, who *Politico* last year called "the closest thing to a referee" on global tax issues. The challenge now will be to keep searching for global consensus without stalling the effort completely. "We have blueprints; we know where we're heading. We now need a political impetus, a reset of the negotiation."

As part of its base erosion and profit shifting work (a set of policies designed to make sure companies pay taxes in the same places where they profit), the OECD has laid out a two-part strategy. One element aims to change the way companies show presence in a country, which makes a particular difference for industries with new business models that are based on data instead of physical factories. The other element tackles the question of minimum taxation, to ensure corporate profits are taxed somewhere and not exempted out of all jurisdictions—similar to the US global intangible low-taxed income (GILTI) regime, enacted in 2017, which sets a floor on what companies have to pay.

The OECD estimates its proposed changes, combined with the US GILTI regime, would bring in new tax revenues totaling about $100 billion a year, about 4 percent of global corporate income tax revenues. Most of the increased revenue would come from the minimum taxation element. The proposals for new business models would yield only a "modest amount," according to the OECD, with revenues shifting from investment-hub countries to other economies.

President Joseph R. Biden, who took office in January, plans to reset America's approach to trade, technology, and transatlantic ties as part of a broad recommitment to multilateralism. That does not mean the United States will stop pushing back on digital taxes already in place. While details vary, such a tax "frequently discriminates against nonresident businesses and imposes double taxation," said Treasury Secretary Janet Yellen in comments to the Senate. She said the administration wants to address those concerns while being mindful that retaliatory sanctions can hurt US households.

Techno-nationalism

Taxes on the digital economy can take a variety of forms. Some are as simple as consumption taxes on internet purchases or service subscriptions. Others that aim to assess profitability and separate out digital companies from other parts of the economy are more complicated. On top of that, there is a question of how digital taxation fits in with other transatlantic tech policy showdowns over privacy, competition, and government subsidies.

"I do believe there is a certain amount of techno-nationalism that is taking place. At the same time, that doesn't mean intervention is unwarranted," said Marshall Van Alstyne, professor of information economics at Boston University, whose work on the issue has included unpaid consulting services to the European Commission and to Facebook.

Economies of scale justify singling out the biggest tech firms, which can aggregate data from millions of users in ways that smaller companies can't match, Van Alstyne said. Whereas traditional companies tie their products together by, for example, selling inexpensive printer hardware to increase sales of paper and ink cartridges, the tech platforms offer free services to one part of the market in order to maximize revenue from other sectors, like trading free email accounts for aggregated advertising data or giving away social network news feeds in order to capture social network information. "Platforms are fundamentally different business models. They are

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inverted firms where users outside the organization create much of the value," he said.

Not everyone agrees. J. Scott Marcus, a former senior technology advisor to the US Federal Communications Commission, said the challenges raised by digital platforms are similar to those in some traditional industries, but on a bigger scale. In his view, tech's main advantage is how easy it is to move assets around. "For digital companies, the question of where they park the assets, especially where they park the intellectual property, they have more latitude than conventional companies," said Marcus, now a senior fellow at Bruegel, a Brussels-based think tank that includes Big Tech companies among its members.

To the general public, taxing the digital economy might seem to be a logical extension of seeking contributions from the sectors most able to bear up. Oxfam International, an anti-poverty group that studies taxation as part of its advocacy work, went as far as suggesting governments impose an "excess profit" tax on tech, pharmaceutical, and consumer goods companies that have boomed during the pandemic while other parts of the economy struggled. More broadly, the group holds that the tech sector is undertaxed relative to its economic strength.

"The need to tax the digital companies, and also more in general the digital economy, has received higher attention because of the coronavirus crisis," said Chiara Putaturo, Oxfam's EU inequality and tax policy advisor. "We have seen that digital companies have increased their profits during this year, in contrast to those companies that lost lots of their profits because of the crisis."

Seeking consensus

The European Union has said it wants to start with a smaller number of big companies rather than thousands of consumer-facing businesses all at once as the OECD has mooted, which puts some US firms in the crosshairs. In a 2018 proposal that may form the basis for this year's digital levy plan, the European Commission set outsize thresholds so the plan would catch only companies of a certain magnitude, such as having more than 100,000 users in an EU member state or posting national revenues of more than €7 million. However, the European Union has tried to keep its tax proposals separate from other tech regulations. The digital tax proposals apply to all qualifying companies, not just those from across the Atlantic.

"We need to build a text that generates sufficient income, stable income, and we need to build a text that is not likely to fuel trade tensions," said Benjamin Angel, the European Commission's director for direct taxation, tax coordination, and economic analysis.

Leaders may have agreed to move ahead with a "digital levy" to become a dedicated revenue stream for the EU budget, but that is no guarantee that member states will want this new "own resource" to look like the prior plans. Furthermore, EU tax proposals need to be unanimously approved by all EU member states. Some tax measures have been able to move ahead, but the European Union's proposed common corporate consolidated tax base has been stuck behind this hurdle for years.

This means that the European Union will need to strike a balance between countries that want to move ahead and those that resist adding corporate taxes not part of the global consensus. For Ireland, which has made attracting US tech companies a priority, keeping the European Union from outpacing global standards is the priority. "Any outcome at international level must strike an appropriate balance and be acceptable to all countries, small and large, developed and developing," Irish Finance Minister Paschal Donohoe said in January. Shifting goalposts can make it harder for companies to keep up with requirements and for small countries to set policy in line with global standards.

The European Union's proposals, like many of the digital services taxes being introduced around the world, have been based on revenues and other assessments of a company's entire business, rather than on specific sales and corporate income. This poses a challenge because turnover taxes are generally inefficient and should be restricted to very limited circumstances, said Alexander Klemm, deputy chief of the IMF's tax policy division and coeditor of the new IMF book *Corporate Income Taxes under Pressure: Why Reform Is Needed and How It Could Be Designed*. Generally speaking, he said, it's best to create a tax system that establishes common concepts like profits and taxes them throughout the economy in roughly the same ways. Singling out individual sectors of the economy often runs counter to these principles, even if sometimes useful as a stopgap measure.

The European Union needs cash from many pots to follow through on the promises in its most recent seven-year budget. That means the bloc needs to introduce a digital tax proposal by mid-2021 to meet its current commitments, even if it wants to structure its rules so that they fall in line with global guidelines if and when an agreement is reached.

"You don't raise a tax because you need cash in a certain place," Klemm said. "You think about it in search of the best way to raise money, by creating the smallest distortion and the lowest cost of collection. It leads to bad tax policy to say we need to slap on a tax on some sector because we need cash in one special pot."

The global debate over why and how to tax digital companies shows the incredibly rapid shift in attitudes toward corporate levies in recent years, said Michael Keen, deputy director of the IMF's Fiscal Affairs department: "After decades of nothing much happening in international tax, everything is now up for grabs." FD

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