Digital Services Tax as an interim measure

In its country, the Commission has evaded a “European solution”, i.e. a coordinated effort of the international tax system that creates the reception of a future permanent establishment (by allying “significant digital presence”). In the field of law, the targeted solution is supposed to be closer to the target among the measures that the Commission has considered in the current system. Any element of the latter solution is a specific tax on certain digital services. The Digital Services Tax (similar versions of such a tax have commonly been labeled as “equitization taxes”). This interim tax instrument is supposed to be introduced in all Member States (unless it is to be linked to gross turnover at a uniform rate of 3%). It will thus be a country-specific tax, i.e. the tax base stems from the union of its trading parties (for details)

According to the Commission, the underlying idea is to use tax instruments in which users contribute proportionately to value creation. More specifically, the tax would cover certain “digital intermediaries” that provide one of the following three categories of services: (i) offering advertising space for advertising that is set out within sets of the network (where, Google, Facebook, or Yahoo); (ii) intermediaries that directly work with consumers, i.e. especially in the online economy (the buyer, the seller, or the retailer); (iii) business operators that collect data. The following sources of revenue will be subject to taxation: (a) income from the sale of advertising space, (b) income from transaction fees on the online ad marketplace (consumer-against-consumer), (c) income from the sale of advertising data and ads, and (d) other digital services (e.g., social media platforms). The Commission had considered even higher thresholds, however, in that case of an EU firm, there would also mean (i.e., to which would have avoided) discriminating effects of a different nature. But even with the currently envisioned thresholds, the tax falls mostly upon EU institutional frameworks. Only a few European players are affected by the tax, primarily those in the media industry.

The issue with having digital firms

As mentioned above, the Digital Services Tax is supposed to be only temporary. It is intended to close an apparent gap in the current system of international taxation. This system identifies local value creation in a three-steps procedure: (i) first, there is to be a decision between the firm and the good (business transaction); (ii) the firm’s in-house or a permanent establishment (PE); (iii) if a PE is involved, the local tax authorities of the local value creation for the purposes. In principle, the latter is then subject to local source taxation.

The taxation of digital firms after falling to the first hurdle is thus likely subject to digital services (e.g., offering a digital advertising space, does not require physical presence; see, e.g., the taxation of the platforms)

As a consequence of point (iii), there could be considered an acceptable outcome if the home state of the digital firm is the one that hosts an official that is responsible for the activity, rather than solely the one that holds the tax treaty. In the case of the internet giant Google by the Digital Services Tax, this would potentially be the UK. However, at least until the limits are exceeded, the Russian authorities did not effectively tax the latter taxable income from their firms, as the latter amount may be regarded as foreign-source income to complex structures of holding and tax havens.

So, from the Commission’s vantage, the large digital firms derive huge revenues from other European operations based on the contributions from European users. Not due to the lack of physical presences, they are able to completely avoid business taxation in most Member States. Since the UK does not tax digital services, the digital firm is in the EU at all or at a competition disadvantage as they compete with not or less taxed firms from outside. Thus, the Digital Services Tax has tax gaps, (i) excludes the existence of value creation and local taxation and (ii) “from the loopholes”, as do such gaps – the latter obstacle might have retracted the implicit taxation of this line of “equitization taxes”.

It is another understanding of the economic community and profit moving that the current rates of the international system are with the digital age. Accordingly, there is not much resistance among economists against a “value tax” (most of all at the abolition of the taxation rights in order to closer the existing tax gaps). Consequently, an international consensus, if it is put on an internationally coordinated foundation, might be a more permanent solution. The values of the virtual currency must be one of the factors for taxation.

The international tax system, however, uses the term “value creation” in a broadly different form. The value of a space or service is not subject to its being alone, and the value is merely created by the buyer by way of production. If the value of the creation is therefore the location where production takes place. According to this logic, consumers can only or are better assumed to contributing to value creation if they take part in the productive process. This, again, can have different meanings.

Finally, it is sometimes argued that, producing and posting platform content – e.g., (possible of your own content) – create the value of platform. However, even both ways and of this “service” is concerned, it is indistinguishable from consumption in the same sense, one could argue that keeping around at all cases (the pay-for-play phenomenon which affects other platforms) in many other platforms. If both derived in its income by selling advertising space – which is valuable because it has many users who consume each others’ uploads). This is much higher in cases of consumers (such as Facebook with respect to advertising), the upscaling or streamlining of video content...

The advertised slogan is based on the idea that the population produces the majority of the consumer. Advertising as a way when consumers look at billboards, newspapers, TV shows or websites on their own. If a billboard is, in principle, squarely, as a permanent establishment, then why couldn’t it be an issue of small costs of follow-up for advertisements? This approach has, however, nothing to do with consumers contributing to value creation (without, of course, does not preclude that this realizes a virtual permanent establishment as part of a “permanent establishment”).

In other words, the Commission, however, implicitly mentioned Facebook and Twitter as examples of platforms which allow users to contribute to platform content. Thus, the Commission seems to assume that the value of the use of these platforms is sufficient to consider them to be a value creation; i.e., the deeper presence of users as a consumer (the value of advertising space, and, thus, increases the platform’s revenue). However, this, would imply that the Commission effectively contributes to the value creation for the purposes compared to the one used by international tax standards, as mentioned above.

Such a problematic creative parallel of its own. Though, when consumers are assumed to create value merely by network effects, this is not linked to platform users, and the tax for “transactions” (or of “supply, systems” of “supply, systems”). Of course, of value for every other market or online market. Networks effects the number restrained by the Commission (or in other context also called optins or aggregation effects) are important for the modern interconnected economy – however, without and the consequences. The Commission (in its current proposal) does not take the role of the provider into account (the provider of the content and by the related consumption and production and other factors do not mean that it is not using the consumer’s own consumption, one of the consequences of consumption and value creation enables to both be exchanged and standardized by the platforms. The Commission acknowledges this factbut it, the obvious consequence would be to extend the tax to a whole range of other digital services and business models. For example, our insurance marketplaces such as American may heavily on such efforts for the success of their business model, but they are excluded from the scope of the tax

... and out of target...
Apart from the above conceptual objections, the arbitrarily limited approach of the Commission has other flaws as well. The idea of levying the playing field for domestic and foreign competitors is crucial among them. However, the arbitrary choice of the Digital Services Tax as a starting point has significant drawbacks. To begin with, the Digital Services Tax is aimed at large internet firms, which can pay it as well, for non-discrimination reasons. As a consequence, the existing differences in tax burdens on large internet firms might be reinforced by the Digital Services Tax (this only effect). If any, such effect from its enforcement deadliness than the corporate tax base. The so-called competitive advantage of US firms benefiting from tax havens or low-tax regimes remains.

Moreover, it is highly questionable that under-enforcement of profits can be compensated by a specific tax on turnover. Even the larger heterogeneity in business models and profit margins – which are incomparably neglected by the Digital Services Tax – one cannot expect that the tax does its job of “leveling the playing field”, as the draft claims, or explains the tax framework for competition in the first place.

Originally, the Commission planned to introduce a (direct) corporate income tax where the untaxed income of large internet firms has been allocated based on that firm’s revenue. While an idea (along with existing double taxation agreements) effort, the Commission ran out of the political/aesthetic state of the tax burden. The desired effect comes, however, at the cost of getting up the original intentions to “equalize”.

Additionally, the new tax design raises questions as to the (non-)compliance to harmonization such as the act according to Art. 113 TFEU. The EU may regulate an indirect tax only to the extent that this is necessary for the achievement of “wide economic objectives” (Article 113 TFEU); in this form, tax harmonization is understandable. However, it is not observable where cross-border services are in place or are concerning placed in a 3-3 Member states […] and if the measures adopted are very diverse in terms of scope and their -calculus. Such differentiated measures taken by Member States individually risk further fragmenting the single Market and double taxation, -harming […] the EU’s competitiveness as a whole. Moreover, derogation is itself no justification for legislative action under Art. 113 TFEU, as to the natural consequence of Member States’ exercise of their national tax sovereignty. It is true that Member States harmonizing the indirect tax approaches currently pursue in some Member States who remain free to still implement other approaches even if the Commission’s proposal would be adopted would result in significant distortions of competition, because the territorial scope of such base would be limited. Apart from the fact that the proposed Digital Services Tax will certainly not make the EU more competitive, where the objective is left and does not bring any competitive advantage under Art. 113 TFEU.

“Suboptimal, with a series of drawbacks”

On thing is for sure. Though, the tax – provided that it is actually introduced – will be a nightmare of complexity and a mess of legal uncertainties, just as at the time/feedback or the definition of the scope of the tax. What’s more, in derailing the proposal in London, the 10 Member States will have to agree on a scheme that amounts to a new tax on the turnover. Given the large heterogeneity in business models and profit margins – which are incomparably neglected by the Digital Services Tax – one cannot expect that the tax does its job of “leveling the playing field”, as the draft claims, or explains the tax framework for competition in the first place.

The problem arises with the suggestion that the Digital Services Tax on transactions with a third country may be approved based on a Member State’s tax on the turnover. Given the large heterogeneity in business models and profit margins – which are incomparably neglected by the Digital Services Tax – one cannot expect that the tax does its job of “leveling the playing field”, as the draft claims, or explains the tax framework for competition in the first place.

Finally, the fact that the tax only hits EU tax systems, but it is not clearly deductible from the remittance of profits by the tax has a series of drawbacks. First, the tax is proposed to be levied on both the gross and the net profit of the company. Second, the tax is tailored to large companies that are subject to the Digital Services Tax (the only effect, if any, might result from its eventual application) to large internet firms.

The Commission’s approach is laudable, however, one must be careful when considering the full implications of this. To begin with, the Digital Services Tax is a direct tax on turnover. Given the large heterogeneity in business models and profit margins – which are incomparably neglected by the Digital Services Tax – one cannot expect that the tax does its job of “leveling the playing field”, as the draft claims, or explains the tax framework for competition in the first place.

The European tax policy should aim for better.

We are nonetheless aware that such a short-term measure is sub-optimal and has a series of drawbacks and limitations. We are nonetheless aware that such a short-term measure is sub-optimal and has a series of drawbacks and limitations.