

Taxation and the Digital Economy

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It is widely acknowledged that Europe lags behind when it comes to digital entrepreneurship. The largest players in the digital economy are based elsewhere, primarily in the US, Japan, Israel, and even China. EU institutions should then look to account for this lack of innovation and address the problems that are holding back the European digital sector. Easing the burden of doing business online would go a long way to foster a thriving tech sector.

The Issue

The debate on taxation of the digital economy provides a clear example of current problems. The Commission Expert Group on Taxation of the Digital Economy has acknowledged the legal and incentive issues associated with imposing a tax specifically aimed at digital businesses. At the same time, however, it followed the line most prominently adopted by the OECD that digital companies have been dodging their fiscal responsibilities by employing base erosion and profit shifting (BEPS) techniques. Similar strategies, it is contended, harm tax collection and distort international competition.

In fact, there is little evidence that any harm is occurring. The effective tax rates borne by digital operations are comparable with those applied to multinational companies in other industries; and corporate tax revenues, measured as a percentage of GDP, have been rising steadily for the past three decades. As regards international competition, a country's tax system is certainly among the factors taken into account by companies when deciding whether or not to set up shop there. However, that is just one of several criteria, the others being regulatory risk, the cost of labor, the availability of natural resources and infrastructures, to mention but a few. Far from being a distortion, taxation is a key element of the international competition for capital.

The EU position

The Expert Group put forward a number of proposals to counter the alleged effects of corporate tax planning on EU economies. While the notion of a separate tax regime was rejected, less radical options for reform have been contemplated that would nevertheless alter the principles of international taxation. Some of them would focus on lowering the threshold for the 'permanent establishment' requirement by reducing the applicable exemptions for preliminary or auxiliary activity, by reframing the concept of agency or by introducing new concepts of virtual PEs. The possibility of moving toward a destination-based corporate tax was also explored by the expert group, with reference to the 2011 Commission proposal for a Common Consolidated Corporate Tax Base, to be later apportioned among individual member states and subject to levy at the relevant national rates. Finally, the Expert Group viewed favorably the OECD proposal for even bolder measures, including a withholding tax on all digital transactions.

A different perspective

Outgoing Commission Vice-President Neelie Kroes famously claimed that "we don't need a Silicon Valley, we have our own." This statement hardly resonates with the reality of Europe's tech sector. If Europe is to gain some credibility as a hospitable business environment for digital companies, it must think of them not as sources for tax revenue, but rather as engines of growth and innovation. A regulatory light touch can pave the way for a more vibrant digital market, but fiscal moderation has an obvious role to play, too. Low taxes benefit companies and customers, which get to retain a larger portion of the value generated, either through lower prices or higher profits. And lower taxes may even benefit government purses through the resulting higher economic growth.

The debate on the taxation of the digital economy ultimately revolves around the possibility for governments to raise taxes on one particular industry. Not only would doing so violate the basic notion of equal treatment, but it would also require a deep overhaul of international taxation and deal a massive blow to tax competition. What Europe's tech sector needs is exactly the opposite: governments that do not play favorites and compete with each other to provide companies and customers with the most favorable business environment at the lowest possible cost.

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Further reading:

Trovato, Massimiliano. "Digital taxation: a solution in search of a problem?"
http://www.brunoleonimedia.it/public/Papers/IBL_SR-Tassazione_Digitale.pdf

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