THE CASE AGAINST TECH TAXES

A critical assessment of EU plans for taxes on digital turnover

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Summary

- This paper explains why additional taxes on the turnover of companies with a large digital presence would be disproportionate, discriminatory and damage the European economy. They would further complicate the tax system for no obvious benefit, but substantial costs.
- The European Commission has proposed a new set of EU-wide taxes on the activities of digital companies. In the meantime, several national governments have announced plans for their own taxes targeting the tech sector.
- This paper reviews the Commission's proposals and the state of play in four individual countries – France, the UK, Italy and Spain – drawing on the local knowledge of think tanks in each case.
- These initiatives are based on the presumption that the tech sector does not pay its 'fair share' of tax. The justification for this claim is flimsy. Indeed, many advocates of a tech tax have resorted to what could best be described as 'policy-based evidence-making'.
- In reality, the effective tax rates paid by traditional businesses are often lower than those paid by digital companies. Where digital companies do pay less tax, this is usually for good economic reasons, or a result of tax breaks that governments themselves have promoted.
- The EU proposals also seem to be designed to target large US-based firms, who are far more likely to be captured by the revenue thresholds and other criteria than EU businesses. This appears to be a de facto tariff which is in breach of international trade rules.
- It has been argued that some of the 'production' of digital companies takes the form of value created by users themselves, and that it is reasonable to tax turnover related to this activity in the country where it takes place.

- However, user-created value is not unique to the tech sector. It exists in any business where firms respond to signals from customers. There are also many practical problems in deciding where and how much value is being created on this basis.
- What's more, taxes are ultimately paid by people, not companies, which are no more than legal structures and cannot bear the economic cost of taxes themselves. Turnover taxes have particularly large deadweight costs, are more likely to be passed on to consumers, are a major deterrent to investment, and can lead to very high effective tax rates when expressed as a percentage of profits.
- In short, the proposals for digital services taxes appear to be driven more by politics than by a proper assessment of the economic and fiscal implications. It would make far more sense to reduce existing distortions in the tax system instead of adding new ones.
- Politicians should also seek to correct public misunderstandings about the economic burden of taxation, instead of reinforcing and exploiting them for short-term electoral gain.

Introduction: why tax digital companies differently?

There is a widespread presumption that global technology companies are not paying their 'fair share' of tax, especially on activities in the EU. This has encouraged the European Commission to propose a new EU-wide tax on digital revenues. In the meantime, several national governments have announced their own plans. France has been first out of the blocks with a so-called 'GAFA tax' (taking the first letters of Google, Apple, Facebook and Amazon), while the UK intends to introduce a Digital Services Tax in April 2020. Italy and Spain are working on proposals too.

All these initiatives have tapped into popular distrust and hostility towards the tech giants. A good example is an opinion piece by Philip Stephens, 'Three cheers for the European Commission's tax on tech' (published in the Financial Times on 21st March 2018), which declared that '*the moment has come to rein in the digital behemoths*', and that the '*likes of Facebook, Google and Apple cannot indefinitely be permitted to shirk any responsibilities to the societies in which they operate*'.

Other supporters of some form of tech tax have pointed to a wide range of concerns over the behaviour of digital companies, including alleged abuses of personal data, failure to protect young people or tackle extremism, the dissemination of 'fake news', claims of external interference in elections and referendums, and even poor working conditions. However, the tax system is not the place to find solutions to these problems, which are issues for civil, criminal or electoral law, regulation, or labour market policy.

The evidence that some tech companies pay less tax is also overplayed. This is crucial, because supporters of a tech tax often cite survey evidence suggesting that a majority of the public think that digital companies pay

too little tax. They then conclude from this that some action is needed to '*restore confidence*' in the fairness of the tax system. However, rather than this action being an attempt to correct the many misunderstandings here, most politicians and commentators have gone out of their way to encourage them. This is not responsible, evidence-based policy-making.

Indeed, some advocates of a tech tax have resorted to what could best be described instead as '*policy-based evidence-making*'. In particular, the European Commission (2018a) has claimed that multinational digital companies pay an average effective tax rate of only 9.5% in the EU, compared to 23.2% for more traditional businesses. These figures have been widely cited as evidence of systematic tax avoidance, or at least that the tech sector is 'undertaxed'. In reality this interpretation is completely misleading, for two main reasons.

First, these estimates are based on stylised business models for hypothetical companies, rather than data from actual firms. It is therefore simply wrong to suggest that they prove anything about the behaviour of the tech sector as a whole, let alone any individual firms. Bauer (2018, 2019) provides compelling evidence that the effective tax rates faced by global tech giants are often higher than those paid by more traditional national champions, such as Deutsche Telekom, Renault and VW.

Second, even in the stylised examples, the main differences in effective tax rates are due to incentives that governments themselves have introduced, notably the more favourable treatment of R&D and intangible assets. The European Commission's claim was based on a report by PWC et al (2017), which explained the lower effective tax rate for digital businesses as follows:

> '*The reason for this is an assumed higher proportion of costs that do not require capitalisation in the investment structure (in particular software developed in-house and intangible assets) as well as more favourable depreciation rules for digital capital goods and the applicability of special tax incentives for research, development and innovation*.'

Media headlines about the tax bills of individual tech companies are often misleading too. Commentators frequently make unfavourable comparisons between the turnover or revenues that a company makes in a particular country, and the corporate taxes it pays in that country. This is disingenuous, for three main reasons.

First, corporate taxes are usually paid on profits, not turnover or revenues. An online marketplace, for example, might see a lot of business transacted between third parties on its site, but still be making only small profits itself, or even operating at a loss. In other words, turnover alone may be a very poor guide to taxable profits, or the ability to pay tax.

Second, tech companies may simply be taking more advantage of tax breaks that are also available to any business in any sector. These breaks include tax credits for employee share schemes, as well as the examples of favourable depreciation rules and incentives for R&D cited in the PWC paper. It might be that the nature of their business models and compensation packages allows tech companies to benefit more than traditional firms from these tax breaks. But that does not reflect any 'bad behaviour' on their part. Indeed, the reverse could be true – it reflects the fact that the tax incentives are working to encourage the behaviours that the policymakers were seeking when they designed them.

Third, in those cases where a company does not have a physical presence in a country, it is surely reasonable to expect it to pay less tax in that country. This is because the company is not making the same demands on local taxpayer-funded public services or infrastructure. A similar argument applies to an online retailer which might be able to reduce its liability for local government taxes (such as business rates in the UK) by operating from a larger and relatively efficient out-of-town warehouse, rather than a shop on an expensive city-centre high street.

This third point is particularly relevant to the accusation that multinational tech companies are avoiding '*responsibilities to the societies in which they operate*' if they pay less tax than comparable domestic firms. After all, a Chinese company making goods in China for export to Europe would still be expected to pay corporation tax on its profits in China rather than the EU. Shouldn't the same logic apply to a US-based website? The general principle is that profits should be taxed in the country where goods and services are produced, and hence where the value is created, rather than where they are sold.

The European Commission has argued that an exception should be made for digital companies, for two reasons.

First, the Commission has noted that these firms often depend on hard-to-value intangible assets, such as the intellectual property embedded in

technology, algorithms or brands. It might therefore be easier for digital companies to minimise their tax bills by allocating assets to business units in lower tax countries and claiming that the bulk of 'production' takes place there.

However, this argument also assumes that digital companies are indeed exploiting these loopholes. A blanket tax rise for all digital companies, whether or not they are avoiding taxes, would be a pretty crude way to address a potential problem that is certainly not limited to the tech sector. It makes far more sense to target this sort of behaviour directly wherever it may occur. For example, the UK's Diverted Profits Tax (which charges a punitive rate on profits deemed to be routed via 'contrived arrangements' to tax havens) potentially applies to any company whatever their field.

Second, the Commission has argued that some of the 'production' of digital companies takes the form of value created by users themselves, for example by participating in online auction sites and social networks, or providing personal data that a digital company can then use to target advertising more effectively. Arguably, then, this part of 'production' actually takes place in the country where the goods or services are consumed, and it might be right to tax it there.

This is a more subtle argument, but still unconvincing. For a start, products with user-created value are nothing new, and certainly not restricted to the digital sector. In practice, user-created value exists in any business where firms respond to market signals from customers.

What's more, many traditional businesses benefit from value contributed by foreign nationals without being expected to pay additional taxes (whether on revenues or profits) in other countries. Examples here include airlines flying foreign passengers, shipping firms involved in the import and export of goods, and providers of international and telecommunications services.

Indeed, many 'traditional' businesses now have an online element, raising the risk that decisions about what is and what is not within the scope of a digital tax become increasingly arbitrary and distortionary. Treating digital companies less favourably also runs counter to the European Commission's own objective of supporting the development of the Digital Single Market.

There are many practical problems too in deciding where and how much value is being created on this basis, as those designing the national proposals discussed in the rest of this paper have begun to find. This is

even before considering the disadvantages of corporate taxation in general, and turnover taxes in particular, to which we will now turn.

The case against turnover taxes

Most economists and tax specialists agree that corporate taxes are a particularly inefficient way to raise government revenue. For example, empirical work by Arnold (2008) for the OECD (2008) found that corporate taxes have the largest deadweight costs on economic activity, and particularly on investment and entrepreneurship. This is partly because it is relatively simple to avoid these taxes by relocating to a lower-tax jurisdiction elsewhere.

Unfortunately, of course, corporate taxes are relatively popular with many politicians and the general public, as Whyte (2019) discusses in the context of offshore financial centres. This seems to be especially true of taxes that are paid by 'foreign' companies. For some European politicians and commentators, it seems hard to find a more attractive target than US-based tech giants.

Crucially, the economic impact of taxes paid by companies is usually less visible than that of taxes paid directly by individuals, and more widely dispersed. This asymmetry, discussed in OECD (2010), reinforces the tendency for politicians to undertake piecemeal reforms of the tax system that might attract support from swing voters, but which actually reduce welfare in aggregate.

There is also a perception that if companies are forced to pay more tax, the burden on others will be reduced. As Zuluaga (2016) put it, '*the belief that corporation tax is actually paid by corporations – understood as somehow an independent entity from their owners, workers and customers – continues to be widespread*'.

In reality, taxes are ultimately paid by people, not companies. Companies are no more than legal structures and cannot bear the economic cost of

taxes themselves. Part of the burden of an increase in corporate tax will be borne by shareholders, who may be better off than the population as a whole. In this sense at least, corporate taxes might contribute to the progressiveness of the tax system. But the burden will also fall on workers (fewer jobs and lower wages), customers (in the form of higher prices), and the wider public (lower investment and economic growth). Indeed, when the costs fall more on lower-income groups, corporate taxes could actually be regressive.

Some of these problems might appear to be reduced by taxing turnover rather than profits. Supporters argue that turnover taxes are relatively transparent and harder to avoid. They also argue that turnover taxes would be more likely to ensure that companies pay tax in the countries in which they operate, even they do not report any profits there. But there are at least four reasons why taxes on turnover are more damaging than taxes on profits:

1. turnover taxes are a direct tax on economic activity, meaning the deadweight costs are likely to be even higher;
2. they are more likely to be passed on to consumers, especially where companies are operating on thin margins or even at a loss. In this respect, they are little different from consumption taxes, such as VAT, which are almost always matched in higher prices, even if the taxes are collected by the company that sells the good or service.
3. Turnover taxes would be an even bigger deterrent to investment and expansion. Taxes on profits at least allow companies to offset part of the cost of capital spending in the form of a lower tax bill.
4. Turnover taxes can lead to very high effective tax rates when measured relative to profits. Consider, for example, a hypothetical company with revenues of £100 million and costs of £94 million, resulting in a profit of £6m. If it has to pay an additional 3% tax on revenues, reducing them to £97 million, profits would be halved.

As we shall now discuss, those designing the proposed taxes on the turnover of digital companies have attempted to alleviate at least some of these problems, but only at the cost of further complication for even fewer potential benefits.

EU: the European Commission's proposals

On 21st March 2018 the European Commission (2018b) proposed new rules '*to ensure that digital business activities are taxed in a fair and growth-friendly way in the EU*'. The Commission identified two problems. First, that the current corporate tax rules '*do not capture business models that can make profit from digital services in a country without being physically present*'. And second, that the rules fail to recognise '*the role that users play in generating value for digital companies*'. As a result, the Commission argued that there is a potential disconnect between where value is created and where taxes are paid.

In response the Commission has made two specific proposals:

First, a fundamental reform of the corporate tax rules, so that profits are taxed where businesses have significant interaction with users through digital channels. This could be integrated into the Commission's proposal for a Common Consolidated Corporate Tax Base (CCCTB), the aim of which is to create a single corporate tax system across the EU for digital and conventional companies, reducing compliance costs and making it harder to shift profits arbitrarily to low-tax jurisdictions. This is the Commission's preferred long-term solution, as outlined in European Commission (2016).

Second, the Commission has proposed an 'interim tax' on certain digital activities, which will be applied to revenues rather than profits. This digital turnover tax would be charged on revenues from activities including digital intermediation (such as online marketplaces and auction sites), the selling of data generated from user-provided information, and online advertising.

The Commission has tried to minimise the problems posed by any turnover tax by proposing a low initial rate of 3%. The tax would also only apply to companies with total annual worldwide revenues of €750 million and EU revenues of €50 million. It has been suggested that this might raise a total of around €5 billion annually from between 120 and 150 companies, with the US firms that dominate the global rankings – see, for example, McKinsey Global Institute (2016) and UNCTAD (2017) – likely to face the biggest bills. However, this means that the digital tax is more of a political gesture than a serious revenue-raising measure. Indeed, revenues of €5 billion would not go far when spread across all EU members.

There are also legal issues. It is no surprise that the digital tax proposals have not been well-received in the US, given that they will overwhelmingly affect providers who are based there. US lobby groups have already argued that EU's interim digital tax would be a trade barrier that would have a seriously negative impact on the transatlantic digital economy.

It is at least arguable that the proposed digital tax models would violate the national treatment principle in article XVII of the WTO General Agreement on Trade in Services (GATS). This is because in practice, and perhaps even by design, they discriminate against US service providers, contravening the EU's commitment to give service providers from other WTO members treatment no less favourable that it accords to its own like services and suppliers.

Specifically, Article XVII explains that '*formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of any other Members'*. The fact that the digital tax would formally apply equally to US and European service providers would therefore not be a defence to de facto discrimination.

As Hufbauer and Lu (2018) explain, the revenue thresholds, types of activities covered, and definition of 'taxable income', all seem designed to capture large US firms while allowing EU businesses to escape the tax. Indeed, some European officials and politicians have made little secret of their desire to target US tech giants specifically.

This opens up the possibility of action being taken by the US in the WTO if a digital tax were to be implemented at the EU level, or in any member state. The US could also take unilateral measures, such as an investigation

under section 301 of the Trade Act 1974, which could lead to tariffs on EU exports in retaliation if the measures were found to be '*unreasonable, discriminatory or unjustifiable*'. The US is currently using this mechanism to seek to counter China's intellectual property violations and technology transfer requirements.

This will also complicate future negotiations on a free trade agreement between the US and the EU, and indeed between the US and the UK. The UK government consultation indicates that it has considered the compatibility of the digital services tax with double tax treaties, OECD principles and Model Tax Convention, but it does not address compliance with the GATS.

The Commission's preferred long-term solution is flawed too. The Common Consolidated Corporate Tax Base (CCCTB) would be used to calculate the total consolidated taxable EU profits of a multinational company. These would then be allocated between Member States according to their shares of sales and the amounts of labour and capital employed. Each State would then tax its share of the profits at its own national tax rate.

This solution would be complicated and require a high degree of coordination across the EU. Unless national tax rates were harmonised (which would undermine sovereignty and lose the benefits of tax competition), there would still be scope for companies to play the system to minimise their tax exposure. And any model that depends on allocating capital to individual countries would be particularly hard to apply to the intangible assets of digital companies. The whole system would rely on regulators and tax authorities making sweeping judgements about business activities that would inevitably be open to challenge.

Finally, it would set a dangerous precedent. If the EU unilaterally decided to tax some of the profits of a non-EU company, even when that company has no physical presence in the EU, what is to stop other countries from retaliating? For example, China could try to tax the profits of European car and aircraft manufacturers selling into China. A tax on digital services turnover would raise similar issues.

France: the 'GAFA' tax

Since 2017, France has made many efforts to enact a 'digital giants' tax at the EU level, and failing that, at the national level. After President Emmanuel Macron came to power in May 2017, Bruno Le Maire, Minister for Economy and Finance, took over the project. Le Maire has championed the tax as a 'fairness issue' [1] and a matter of '*refusing to allow digital giants to have a tax level in Europe 14 points lower than that of other companies and that of manufacturing enterprises*.'[2]

The Minister has repeatedly highlighted this supposed differential taxation in his speeches and exchanges with the press.[3] His idea is to ensure that '*Google, Apple, Facebook, and Amazon (GAFA) pay their taxes at the appropriate level*.'[4]

1 Bruno Le Maire, Minister for Economy and Finance, Speech to the Fifth Summit of the Economy, "Reconciling the Two Frances", Paris, Thursday 6 December 2018, available at https://minefi.hosting.augure.com/Augure_Minefi/r/ContenuEnLigne/Download?id=D038C06E-8956-4928-B0B5-3DB149368C79&filename=899bis-%20Discours%20Bruno%20LE%20MAIRE%205e%20Sommet%20de%20l%27Economie-1.pdf

2 Bruno Le Maire, Minister for Economy and Finance, Speech, Bercy, Friday 16 November 2018, available at https://minefi.hosting.augure.com/Augure_Minefi/r/ContenuEnLigne/Download?id=3B78EA10-DA19-4DFC-82E2-B98D89CAB523&filename=857%20-%20Discours%20Bruno%20LE%20MAIRE%20-%20Conf%C3%A9rence%20OMC.pdf

3 See, for example, Bruno Le Maire, Minister for Economy and Finance, Statement to the press, Bercy, 14 January 2019, available at https://minefi.hosting.augure.com/Augure_Minefi/r/ContenuEnLigne/Download?id=FBA6391F-09F8-405E-9D83-1BD77A54BEA1&filename=961%20-%20Discours%20de%20Bruno%20Le%20Maire%20-%20Voeux%20%C3%A0%20la%20presse%20-%20Lundi%2014%20janvier%202019.pdf

4 Bruno Le Maire as quoted by Hervé Gattegno, "GAFA tax: Bruno Le Maire announces an upcoming European directive", Le Journal du Dimanche, 3rd March 2018

As it happens, the fact that French officials and commentators are calling it the 'GAFA' tax, even colloquially, simply underlines the concerns about compliance with GATS. But from a political perspective, Le Maire's approach is quite audacious. He is from the French political right-wing, thus expected to be pro-business. He is, however, a minister in a government positioning itself as a new alternative, differing from traditional political movements that have dominated French political life since the beginning of the Vth Republic in 1958. Emmanuel Macron himself has sought to transcend the traditional parties and challenge the left-right divide.

In becoming the spokesman for GAFA taxation, Le Maire is reusing themes dear to his former opponents. Over the past few decades, the French left has multiplied its attacks towards multinationals in general, especially US multinationals. Although this opposition decreased following the decline of the Communist Party and its associated unions (the CGT) in the 1990s, it recently intensified again. NGOs (such as Oxfam and Attac) are increasingly active in public debates, and are also leading the fight against inequality and globalisation.

Regarding public finances, Le Maire's approach could be seen as ingenious. France has become one of the most taxed countries in the world. Government revenues represented 54% of GDP in 2017. This extraordinary level of taxes only exists elsewhere in oil-rich countries where revenues aren't likely to dry up under the tax burden. Ranking second behind Kuwait, whose taxes represent 57% of GDP, France is followed by Norway and Libya.[5]

One might think that these taxes were more than enough to balance the public accounts, but this is not the case. France's books were last balanced in 1974. At the time, both revenues and public spending represented 40% of GDP. Since then, spending has increased by 17 points (57% of GDP in 2017), while revenues have increased by 14 points (54% in 2017). As such, gross debt has increased six-fold in less than half a century (from 15% of GDP in 1974 to 99% in 2017).

5 With tax revenues representing 53% and 51% of GDP according to the IMF.

The central government has particularly large problems.[6] The French state, incapable of balancing its budgets, is constantly searching for additional sources of revenue. It is showing an incredible fiscal creativity, with its approaches being less and less welcomed by entrepreneurs and taxpayers. [7]

In this context, creating a tax on digital companies who don't pay their 'fair share' of taxes could seem a smart move. For the general French public, this tax would be paid by foreign multinationals. At first glance, it seems that this step wouldn't penalise French companies and consumers. This explains the lack of reaction from a public which is normally highly sensitive on taxation, as shown by the 'yellow jacket' protests.[8]

The choice of a tax on net sales is not neutral. France is a champion of levying taxes on this basis. Taxes on all kinds of activities (including insurance, mutual funds, sugar, and tobacco) generates revenue that amounts to 4.5% of French GDP, compared to an average of 2.3% in the EU28. Even though experience shows that these taxes are disadvantageous for the economy and French consumers, the creation of these specific taxes has sparked little resistance.

Le Maire initially envisaged a European tax which targeted revenues from online advertising, platform intermediation, and data resale. This tax was supposed to represent between 2% and 6% of turnover[9], with this number later refined to 3%. It was supposed to be formalised by a directive based on a common taxation proposal from Paris, Berlin, Madrid and Rome, which was presented in September 2017 during a European Union informal

6 See, for example, Nicolas Marques, Cécile Philippe and Caio Zanforlin, "Credit Day: Improving appetite for fiscal responsibility", Epicenter, December 2018, and Nicolas Marques and Cécile Philippe, "The day when the EU Member States had spent all their annual revenue", Institut Économique Molinari, November 2018.

7 France has rediscovered its familiarity with spontaneous anti-burden and anti-tax movements under François Hollande's presidency. In September 2012, young entrepreneurs led a revolt against an increase in tax on realised gains from their companies' sales – the 'Pigeons' movement. A series of copycat sectorial movements arose: 'Sparrows', 'Sheep', 'Bees', 'Chicks', 'Tondus' - a reference to oversheared sheep – and 'Yellow Hats'. In 2013, Pierre Moscovici, then Minister for Economy and Finance, spoke of 'tax exasperation' but the new tax proposals did not stop. The protests grew even larger with the 'Red Hats' (2014.)

8 At the end of 2018, tax protests resumed under Macron's presidency with the 'Yellow Jackets', a movement notably linked to taxes on diesel used by motorists.

9 Bruno Le Maire as quoted by Hervé Gattegno, "GAFA tax: Bruno Le Maire announces an upcoming European directive", Le Journal du Dimanche, 3 March 2018

finance ministers council.[10] It was projected to generate 3 to 4 billion euros, including 500 million for France.

However, despite intense lobbying effort and support from (the French) European Commissioner Pierre Moscovici, this initiative failed. It was not fully supported by the Germans, who were afraid that the US would counter it with a tax on German cars sold in the US. The tax was opposed by Ireland and Scandinavian countries, especially Sweden, who presumably wants to protect Spotify, its digital giant and the world leader of music streaming.

After the tax stalled at the European level, Le Maire announced the implementation of the tax in France in 2019.The tax would go further than the European plan on both the tax rate and tax base.

Nicknamed the 'GAFA' tax, it will apply on the revenues of the sale of data for targeted advertising, the sale of targeted online advertising, and online marketplaces where their revenues are linked to the participation of French users.

Three examples illustrate what would be taxable:

1. advertising conducted on digital interfaces. The targeted services would correspond to services for the purchase, storage, and distribution of advertising, advertising control, and performance measurement, as well as services for the management and transmission of user data;
2. the resale and management of personal data for advertising purposes;
3. the provision of a digital interface to enable users of platforms to interact with each other in order to exchange goods or services. In a press conference on 6th March 2019, Finance Minister Le Maire stated that only platforms remunerated by a commission fee to enable interactions between users would be targeted. The details here still have to be confirmed.

10 Reuters, "A European proposal for taxing the GAFA", 9 September 2017 https://fr.reuters.com/article/companyNews/idFRL5N1LQ0CT

Activities that would not be taxed include online advertising that does not involve user data, direct e-commerce retailing, messaging or payment apps, regulated financial services, and services provided between companies of the same taxpayer group. More often than not, this will incentivise old-fashioned ways of doing things that are less efficient.

Companies subject to the digital services tax would be limited to those with digital revenue of more than €750 million worldwide and more than €25 million in France. Approximately 30 companies are expected to pay the tax, mostly established in the US (as well as one French group, Critéo, listed on Nasdaq).

The tax is to be pro-rated based on the number of users that companies have in France, but there is no information about how this figure would be calculated.

The draft legislation mentions a flat tax of 3% of the taxable income. Companies will be allowed to offset the tax against French corporation tax.

The Economy Ministry hopes to raise some €500 million a year through the new measure.

The plan is to implement the French tax in the fiscal year 2019. The time frame for the tax's application and first payment was set out in a bill presented cabinet on 6th March. If subsequently approved by parliament, the government expects the first tax payments in October 2019, but the tax would apply retrospectively from 1st January.

The ASIC, the Communal Internet Services Association, has already denounced an *'ideological tax based on a wrong assumption*.' According to the association, this tax would '*impede French actors in their growth*'. It was announced '*without any impact study on the measure of service quality available in France; the international investments in France; the loss of competitiveness of French firms; the legal aspect of a French tax that would add to taxes already paid in business registration and future taxes at the European level*.'[11] It considers that '*the government will seriously handicap French firms, who won't have the capacity to deal overnight with a tax of 3% on their turnover over the threshold. The cost of this measure will be so high that it will encourage firms to stay below*

11 ASIC, The 6 reasons why the digital tax is a bad idea, Paris, 21 January 2019. https://www.lasic.fr/les-6-raisons-pour-lesquelles-la-taxenumerique-est-une-mauvaise-idee/

that threshold.' This sends the message: '*against the digital giants, stay dwarves!*'

For France Digitale, which includes 1,200 start-ups among its members, this tax project on turnover '*sends a very negative signal to all members of the digital economy*.' This new tax carries a potential risk of '*multiple taxation on the same turnover*,' a '*possible knock-on effect from some major digital actors of this tax on their local clients: advertisers, marketplace sellers, applications*', a '*fall in the number of acquisitions of French start-ups*' and '*an integration of the anticipated cost of this new turnover taxation with French start-up repurchase deals*.'[12]

For Tech France, which boasts 400 members from start-ups to major firms, 'this tax includes numerous flaws affecting French actors competing with the platforms targeted.'[13]

12 France Digitale, Position Paper 01/02/2019 "Bill - proposed tax on digital services." http://www.francedigitale.org/wp-content/uploads/2019/02/Taxe-sur-les-services-nume%CC%81riques-2.pdf

13 Loïc Rivière, CEO of Tech in France, cited in Philippe Mabille's article "Taxing GAFA: Bruno Le Maire's plan wakes up the Pigeons.", La Tribune, 2 February 2019.

UK: the ‘Digital Services Tax’

The UK government set out its plans for a Digital Services Tax (DST) in the 2018 Budget, HM Treasury (2018a). The focus is on ensuring that ‘digital businesses pay tax in the UK that reflects the value they derive from UK users’. The DST will therefore apply a 2% tax on the revenues of specific digital business models, namely search engines, social media platforms and online market places, where their revenues are linked to the participation of UK users.

Three examples illustrate how this would work:

1. if a social media platform generates revenues from targeting adverts at UK users, the government will apply a 2% tax to those revenues;
2. if a marketplace generates commission by facilitating a transaction between UK users, the government will apply a 2% tax to those revenues;
3. if a search engine generates revenues from displaying advertising against the result of key search terms inputted by UK users, the government will apply a 2% tax to those revenues.

However, the UK government has also had to recognise the pitfalls in any turnover or revenue tax. To minimise the risk to small businesses, firms will need in-scope revenues of at least £500m globally to become taxable under the DST, and the first £25m of relevant UK revenues are also not taxable. What’s more, there will be a ‘safe harbour’ provision, allowing loss-making businesses to avoid DST and those with very low profit margins to pay a reduced rate.

The thinking behind the UK proposals has been set out in a consultation paper of November 2018 and a position paper updated in March 2018, HM Treasury (2018b). Interestingly, the UK proposals are not based on two factors that feature more heavily in the European Commission's thinking.

The first is the presumption that digital companies are engaged in cross-border tax avoidance or profit-shifting. The UK government has concluded (surely correctly) that this problem is relevant to all businesses, even if some characteristics of those in the digital sector might make it more acute.

The second is the argument that firms are underpaying tax if can generate revenues from markets in which they have limited physical presence. Again, the UK government has concluded that this applies to any global business, and is not a good reason to target the tech sector.

Instead, the UK government has focused on the widely-accepted principle that the profits of a business should be taxed in the countries in which it creates value. They have extended this principle to cover the creation of value by the participation of users in the UK.

This is not unreasonable in principle, but immediately runs into multiple problems in practice. In particular, the UK's plans will require agreement on which activities, and which users, come within the scope of the DST and which do not. This apportionment will have to be 'just and reasonable', leaving plenty of scope for disputes between companies and tax authorities. Indeed, the UK government consultation paper itself lists some potential difficult cases simply in respect of identifying UK users, including:

1. cases where the intended destination of advertising is unclear e.g. where user location is not actively tracked. Indeed, we are likely see more of this as users attempt to bypass controls on internet access designed for purposes such as tackling 'online harms', protecting data privacy, or imposing age restriction on viewing pornography;
2. cases involving users who are mobile across borders e.g. a user who travels for work while participating with a social media platform;
3. cases where the initial payment or registration of a user occurs while they are travelling e.g. if a user normally located in the UK signs up for a service while on holiday.

In summary, the UK's DST seems like a lot of effort and complication to raise a relatively small amount of money (just £275m in 2020-21) as a gesture to tackle a problem that is itself overstated. Even the UK government only sees this as, at best, an interim measure.

Italy: the 'Web Tax'

Constantly looking for ways to reduce the burden of a huge public debt, Italy was one of the first countries to flirt with the idea of hitting the digital economy with a sector-specific tax. For at least the past six years, politicians of all tendencies have devised and advocated some variation of what came to be known as a 'web tax'.

The 2013 Web Tax

In 2013, under the Letta government, Francesco Boccia, an influential Democratic MP who was then chairman of the House Budget Committee, introduced the first bill in the series. According to this proposal, Italian businesses would only be allowed to procure online services from companies carrying an Italian VAT registration. This in turn implied that all businesses aiming to market their online services to Italian business customers would have to be registered in Italy for tax purposes.

The bill was later attached as an amendment to the Italian Budget Law for 2014, which included two related provisions: one looking to widen the definition of 'permanent establishment' to include even the simple transmission of data over Italy's network infrastructures; the other trying to revise the calculation of corporate income for companies engaged in online advertising, where transactions took place with related companies based in Italy.

The reasoning behind the Boccia proposal can be confusing. For all its focus on VAT registration, the plan had nothing to do with VAT itself: as the tax had been harmonized at the EU level for decades, and it was already governed (at least for B2B transactions) by the country-of-destination principle, so VAT avoidance in the digital economy wasn't really an issue. However, by pushing multinational tech companies to register

in the country, web tax proponents were hoping to capture a much larger share of their taxable income.

Ever since it first surfaced, the Boccia proposal was met with fierce resistance. Unfortunately, the disagreement had little to do with the principles it embodied and more to do with legal technicalities. Indeed, most of its critics explicitly embraced the proposal's stated objective of preventing the alleged tax avoidance on the part of tech giants, while only taking issue with the specific normative tools Mr Boccia used to achieve such objective.

In particular, preventing Italian companies from acquiring services from companies registered in other European countries would violate fundamental principles of EU law, openly defying the so-called four freedoms (see, among others, articles 26, 49, 54 and 56 TFEU) as well as the very idea of a European common market. Even more specifically, article 3.2 of the so-called e-Commerce Directive (2000/31/CE) barred all Member States from '*restrict[ing] the freedom to provide information society services from another Member State*'.

The web tax supporters argued that none of this actually applied to the Boccia proposal, since it only prevented Italian companies from doing business with foreign-based online service providers, but in no way did it force the latter to register in Italy. This was clearly ludicrous, as the practical effect of the envisaged rule was precisely the same; and it must be noted that the freedom to exchange presupposes both the freedom to sell and the freedom to buy.

In other words, it was obvious that the Boccia proposal was at odds with established EU law and that, if approved, it would prompt the EU Commission to commence an infringement procedure against Italy. This should have been reason enough to drop the amendment and save the country from further embarrassment. The reason why the plan was set aside, though, was entirely different: when the political landscape shifted within the Democratic party and Matteo Renzi rose to the top spot, he came out against the proposal and caused any support for it to plummet.

The 2015 Web Tax

Ironically, the web tax came back after Mr Renzi ousted Mr Letta and took over as prime minister. A new bill was formulated in 2015 by Enrico Zanetti, then an Economy and Finance undersecretary, and fellow-members of the short-lived centrist party Scelta Civica, which was part of the government coalition at the time. Unlike the Boccia proposal, this plan didn't just purport to subject new phenomena to existing tax laws, but it meant to introduce an outright new tax.

The tax would hit both Italian and foreign companies based on two requirements: first, having an extended online presence in the country of at least six months (this was another attempt to revise the notion of permanent establishment as currently defined by international tax law); second, raising at least €5 million in revenues from Italian customers. A tax rate of 25% would apply to such revenues.

The 2015 web tax was said to have been inspired by the UK's Diverted Profits Tax (DPT), which charges a punitive rate on company profits deemed to be routed via 'contrived arrangements' to tax havens. However, Mr Zanetti's plan differed from its British counterpart in several significant ways. First, it singled out the digital economy, while the DPT does not.

Second, it would require banks and other financial intermediaries to enforce the levy, which would lead to errors and controversy, whereas the DPT relies on UK tax officials to issue a preliminary notice only when they believe the tax should apply and therefore allows for the recipient's objections to be taken into account first.

Finally, while the tax rate is the same, the UK DPT targets actual profits, while the web tax would target gross revenues.

Just like its 2013 predecessor, the 2015 web tax proposal never made it into law, due to changing political winds. Since the beginning, it was mostly intended as a tool to put pressure on EU institutions, which were concurrently looking into ways to address the alleged tax elusion by digital players, and when the Renzi government came to an end in 2016, the Zanetti plan died with it.

The 2017 Web Tax

However, the idea of a web tax didn't die at all and it was resurrected just a year later when Democratic MP Massimo Mucchetti put it forward again as an amendment to Italy's Budget Law for 2018.

The Mucchetti plan shared a few similarities with the Zanetti proposal, but it departed from it in a few major regards. It still tried to widen the notion of permanent establishment to include all instances of a significant and extended economic presence in the country, but it meant to target all B2B digital transactions, even when they concerned services rendered by Italy-based companies; in addition, it would still hit gross revenues, although at a much lower tax rate of 6%, which was later further reduced to 3%.

The final version of the proposal was the outcome of prolonged compromising, which resulted in a few contradictions. For instance, while the proposal was non-discriminatory in that it would hit all companies regardless of their nationality, that also meant that Italian digital companies would face a higher income tax rate than businesses engaged in other sectors.

Furthermore, the tax threshold was defined in terms of transactions (3,000 per year), rather than in terms of revenues, which opened the door to distortions.

In any case, the 2017 web tax was eventually approved, and it did enter into law. However, the Ministry of Economy and Finance failed to publish the prescribed regulations, so that it was never actually applied.

The 2018 Web Tax

Finally, Italy's Budget Law for 2019 repealed the 2017 web tax and proposed a new, heavily revised version. Two of the major changes in the new web tax concern its threshold (it only hits companies with at least €750 million in global revenues and €5.5 million in digital services rendered to Italian customers) and its scope (it clarifies that the targeted services are limited to the provision of online advertising, multisided platforms, and the transmission of data collected about users). These revisions stem from the proposal for a Directive on a digital services tax, currently under discussion at the EU level.

Nevertheless, the new web tax fails to conform to the proposed directive in other ways (for instance, it doesn't include a list of services falling outside its scope), and it doesn't address some of the problems with the old web tax. For example, it still targets gross revenues and it still provides no relief for those companies which are already subject to corporate income tax in Italy, which can result in double taxation.

So where is Italy now? In summary, the latest version of the 'web tax', is intended to cover three types of activity:

1. the provision of online advertising;
2. the provision of online platforms, including those connecting buyers and sellers;
3. the transmission of user data generated and gathered through online services.

The tax would apply whenever the users of the services are based in Italy. All companies with at least €750m in global revenues and €5.5m in revenues from digital services rendered to users based in Italy are subject to the tax, regardless of nationality.

The tax rate is 3% of gross revenues, although the possibility of raising the rate to 6% has also been discussed. Costs can't be deducted, with the exception of VAT and other indirect taxes. Revenues are expected to amount to €150m in 2019.

Spain: 'Tax on Certain Digital Services'

The Spanish government has also proposed a digital service tax levied on online advertising services, online intermediation services, and the sale of data collected from information provided by the user. The main goal of the tax is to '*correct the inadequate allocation of taxation rights produced as a consequence of the lack of recognition of the existing fiscal international rules about the users' contribution to the value creation for enterprises in the countries where these operate*'.

Taxable subjects will be those legal persons and other entities whose net amount of turnover in the previous year exceeds €750 million and whose income derived from services subject to this tax in Spain is greater than €3 million in the previous year.

The tax rate would be set at 3% and the government is anticipating a relatively ambitious €1.2 billion in annual revenues from this tax. This is larger than the amount that might be anticipated from the application of the EU proposals to Spain, mainly because the scope for the Spanish tax incorporates intra-group transactions, and the minimum billing threshold is set at a lower level.

The plan is to implement the tax as soon as possible in 2019, but process has been paused due to the Spanish general elections on 28th April.

There have already been some studies of the potential economic impact. PwC (2019), on behalf of AMETIC and Adigital, has argued that the cost of a digital tax will mainly be borne by consumers and small companies that use digital services. This report concluded that:

1. consumers will experience a loss of welfare between €515m and €665m due to higher prices;
2. companies that use digital services will experience a loss of their operating profit of around €450m and €562m, due to the increase in costs and the fall in sales;
3. these will result in a negative impact of between €586m and €662m on Spanish GDP.

Javier Santacruz Cano has undertaken a similar analysis for Civismo (2018). The main conclusions of this report were that:

1. the margins of companies in the digital services industry in Spain would be reduced by €178m per year. The most affected segments would be digital advertising and intermediation in products and services;
2. the digital tax would subtract just over two percentage points of profitability from average annual sales, albeit with asymmetric impacts on different segments;
3. one third of the cost of the tax is assumed to fall on the final consumer, while the remaining two thirds is met by the intermediaries, in the form of lower margins, reduced investment and lower employment and wages. The most affected companies would be small-and medium-sized enterprises (SMEs), as they mainly deal with the retail sector where there is less scope to pass on the cost to consumers;
4. investment in the sector would be reduced by half a percentage point, as result of the reduced profitability of digital companies;
5. the negative impact on the consumer (including freelancers and others employed by SMEs) averages out at 0.474 euros per capita for each digital product taxed, with the biggest impact on online transactions and data sharing.

Conclusion

This paper has reviewed the European Commission's proposals for a new set of EU-wide taxes on the activities of digital companies and assessed the plans of national governments in France, the UK, Italy and Spain.

It is striking how complicated these proposals are. The repeated attempts to develop a 'web tax' in Italy are perhaps the most extreme example, but in every case the authorities have struggled to come up with a clear rationale for a tax targeting the tech sector, or to explain how the new taxes would work in practice.

This makes it even harder to escape the conclusion that the proposals are driven far more by politics than by economics or by sound fiscal principles. Instead, the main motivation appears to be a desire to tap into the popular antipathy towards certain digital companies, especially those established in the US.

This compounds the risk that special taxes on the tech sector will simply muddle the tax system even further, especially if different governments apply different taxes. They create additional uncertainty too about what might come next. In the meantime, it is surely significant that even most supporters of turnover taxes regard them as an interim measure, at best, until something better can be devised.

It is also important to consider the issue of proportionality. The case for a digital services tax is undermined by the lack of real evidence that the sector is under-taxed. In addition, the users of these services themselves benefit enormously from these business models.

Digital companies often provide services, such as search engines and membership of social media platforms, at no financial cost to consumers,

as well as all the advantages of increased competition and convenience that online marketplaces provide. (For more here see HM Treasury (2019), also known as the Furman Review.)

These companies are also often at the cutting edge of innovation and economic development, making discriminatory taxation even harder to justify.

A better approach would be to lower corporate tax rates generally and to reduce existing distortions in the tax system (including those that are of particular benefit to digital companies), rather than introduce new ones.

Politicians and other opinion-formers should also seek to correct public misunderstandings about taxes, rather than reinforce them.

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