POLICY BRIEF

4 / 2019 — Economy

Digitalisation and Taxation

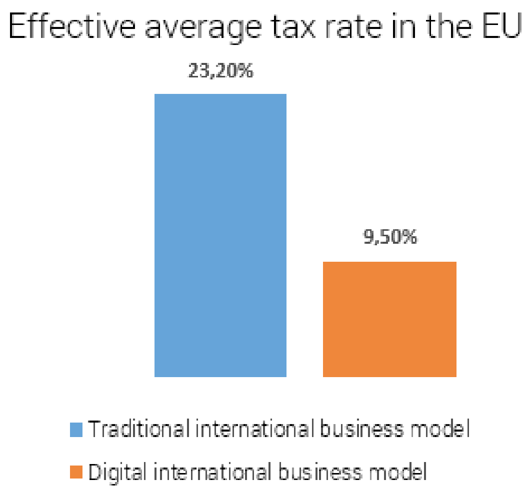
Key points

- Tax avoidance and profit shifting by multinationals pose a significant problem for most EU Member States. Since this problem is so widespread, it has become a major question of equitableness.
- Digitalisation and the increasing importance of intangible assets (brands, algorithms, data, etc.) are additional challenges to international taxation (of profits).
- A change to the system of international profit taxation towards a consolidated profit approach and formular apportionment (including a minimum profit tax rate) is the best way to get this problem under control.
- The current discussions at OECD level regarding the introduction of a global minimum tax rate and a reorganization of the profit allocation rules are generally positive.
- A global (and EU-wide) minimum tax rate is necessary, but should not be lower than 25%.
- A system change at international profit taxation towards consolidated profit analysis and formula apportionment is the best way to tackle the issue of tax frauds.
- The profit allocation rules must reflect digital value creation, for example through the introduction of a digital permanent establishment.
- If OECD talks fail, negotiations on an EU-wide solution must be resumed. The goal must be to prevent a patchwork of national unilateral attempts, if necessary through a coalition of the willing.

Background

The phenomenon of tax avoidance and profit shifting places a significant burden on most EU Member States, their national budgets, and their citizens. The reason for this is obsolete and incomplete taxation systems as well as international profit tax competition. Accordingly, we need to redefine the system of international profit taxation as quickly as possible. A form of unitary taxation, as proposed by the EU Commission via a Common Consolidated Corporate Tax Base (CCCTB) for the EU, would be the most effective means to get the problem of international tax dodges under control.

However, even this change in the system would not eliminate all problems related to tax avoidance and tax fraud. The proposal proves ineffective when it comes to the digital economy because even a profit assignment scheme based on a formular apportionment, as set out in the proposals on unitary taxation, requires a physical presence and hence a local place of business as the necessary precondition for taxation in a particular country.



COM(2018) 146 final, Time to establish a modern, fair and efficient taxation standard for the digital economy

Main findings

Starting Point

Digital business models are currently presenting nation states with considerable taxation challenges. Since they are not bound by any physical presence, any foundation for taxation is often lacking in relation to the giants of the Internet - despite their significant levels of economic activity in the EU. Most tax systems are designed for the giants of industry of the 20th century. However, they are completely unable to cope with the large Internet companies of today which often operate without any traditional places of production. These digital giants operate online, reap added value through intangible assets (e.g. logarithms, trademark rights or user data), and often do not even have a branch in countries where they market their products. It is becoming increasingly common for them to only have a virtual presence in most countries. However, the lack of a physical presence means there is no legal basis for taxing their income.

In addition, the explosion in the importance of intangible assets facilitates profit shifting through the manipulation of transfer prices, i.e. prices applied to in-group services. The arm's length principle usually applied is ineffective because there is no comparable market price for unique patents, etc. In addition, current regulations on the distribution of profits underestimate the economic importance of users. Profits are often assigned for taxation to the country where the headquaters or patents are registered - frequently these are low-tax countries.

Furthermore, digitalisation has triggered a new boom in the so-called "sharing economy". This also poses new challenges to the rules of taxation because there are frequent overlaps between private and commercial economic activities. Private individuals offer free capacities such as living space or vehicles, often for a limited time, in a digital marketplace and hence become microentrepreneurs. This poses two challenges in terms of taxation. First, how can a framework be established that ensures appropriate taxation of such activities? Second, how can international corporations in the sharing economy, which can quite easily be established in tax havens, be made to pay tax on profits where they are generated? Furthermore, developments in the sharing economy make it difficult for tax authorities to obtain information about users of such platforms who are generating taxable turnover or making taxable profits without duly declaring them.

Facts and figures

The question of tax dodges has become a major question of equitableness. While international profit tax competition is pushing corporate tax rates further and further down around the globe, workers and consumers have to shoulder a constantly increasing part of government expenditures on their own. In addition, there is a massive distortion of competition between domestic companies and tax evasion by multinationals, in particular in the digital economy.

And the severity of the problem is accelerating sharply: in 2006 there was only one company from the digital economy in the top 20 companies worldwide. By 2017, nine of the top 20 were from the digital economy and the first four places were taken without exception by them (Microsoft, Apple, Alphabet-Google and Amazon).

The European Commission has calculated that the effective corporate tax rate for multinational enterprises is 23.2 per cent, but for multinationally active internet groups it is only 9.5 per cent. This distortion of competition is harmful to economic growth and employment. But existing tax inequalities are also a political problem. They contradict the right of citizens to equitable taxation systems, result in disillusionment with politics and the EU, and hence give a boost to nationalist ans populist forces.

What must we do?

At OECD level the major industrialised countries are currently discussing possible solutions. At the heart of the debate is a global minimum tax rate and a reform of the regulations on profit allocation rules (e.g. via a digital permanent establishment). A global minimum tax rate would be a simple but effective means of ending the tax evasions of corporations. Following the example of the USA, in addition to domestic companies and their foreign subsidiaries, which are already subject to taxation, the domestic activities of foreign companies would also be subject to taxation. The USA has set its minimum tax rate at around 13%. That is clearly too low. In order to ensure a level playing field for SMEs and traditional enterprises the minimum tax rate should be 25%.

During discussions on a reform of the regulations on profit apportionment, various proposals have been laid on the table, including the proposal on the introduction of a digital permanent establishment. This makes sense, particularly if it is introduced as part of a fundamental reform of the system of international profit taxation towards the formular apportionment of profits. AK sees it as a positive step that the EU Commission has extended its proposal on the introduction of a Common Consolidated Corporate Tax Base (CCCTB) to include a digital permanent establishment. It remains to be seen whether the OECD will succeed in implementing such substantive changes. If not, then negotiations on EU-wide taxation of internet companies should be resumed in 2021 at the latest. Not only the digital permanent establishment, but also the digital service tax proposed by the EU Commission as an interim solution, is up for discussion.

The unequivocal aim of discussions must be to find an EU-wide solution, if necessary through a coalition of the willing. To date, the lack of agreement has led to numerous fragmented national responses, resulting in a patchwork of different solutions.

Austria itself has taken this approach and is a prime example of how national solutions can trail behind the proposals of the EU Commission in terms of effectiveness and extent. While the compensatory tax proposed by the EU Commission would include online advertising as well as the sale of data and platform fees and hence would essentially cover all business models of online advertising (Google, Facebook, etc.) and the sharing economy (Airbnb, Uber, Booking.com), the Austrian model addresses only online advertising.

Besides the issue of how profits are taxed, it is also necessary to ensure that taxes on consumption – which, as a rule, means VAT – are handled properly. Unlike taxes on profits, VAT is largely harmonised within the EU. As a rule, the "country of destination" principle applies, which is of particular significance with respect to online business. This certainly makes sense. The difficulty is, however, that it is often nearly impossible for the tax authorities in the country of destination to check compliance with all relevant regulations and to verify whether VAT has actually been duly paid.

Demands

- Reform of the system of international profit taxation towards a consolidated profit approach and formular apportionment.
- Introduction of an global or EU-wide minimum profit tax rate that is not lower than 25%.
- Abolition of the principle of unanimity in questions of taxation at the level of the EU Council of Ministers.

Literature

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