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The global conversation around digital services tax has been heating up since France introduced its 3% tax on large U.S.-based global tech companies. Without waiting for a unified plan from the Organization for Economic Co-operation and Development (OECD), various countries followed suit. To the discontent of the United States, Italy approved a new digital tax to kick off in 2020, while Turkey proposed a digital services tax in October at the high rate of 7.5%—the same rate recently approved by regulators in Hungary.

The Economic Impact

Current approaches target large multinational companies, but the impact will likely be passed to consumers in the form of higher prices. The relatively small group of businesses those laws and proposals are targeting (approximately 150 companies) pride themselves on providing efficient services and products to people in Europe at a competitive price. The digital services tax could change that.

When the European Union (EU) proposed its digital services tax in March last year, it was estimated to capture around five billion Euro in revenue, which is a relatively low number compared to what businesses would have to spend to comply. The current administrative cost of compliance is already high, and a digital services tax could significantly intensify this burden. This is an expense that could eventually be shouldered by consumers — something companies want national governments to evaluate when weighing a digital tax law.

Trade War Tactic Disguised as Tax

The French digital services tax, as well as a majority of other proposals, look more

Trade discrimination is one of the issues being investigated, as large and profitable companies tend to be U.S. technology businesses, which the French digital services tax targets specifically. Making the law retroactive places an unreasonable compliance burden on those companies that would have to trace back and report past transactions. Invoking the dispute settlement procedure under the WTO law is one of the available legal remedies the U.S may pursue to challenge the French digital services tax. A company affected by the French digital services tax could challenge it before the Court of Justice of the European Union (CJEU). However, an EU subsidiary of a U.S. multinational would need to initiate legal action, as only EU companies are eligible to bring nationality discrimination claims before the CJEU.

Although the current proposals look to tax gross revenue, as opposed to income, they are not considering how the digital services tax can impact future revenue coming from the global technology sector. This cannot be done without insight into domestic and international tax filings of each company.

The Enforcement Challenge

Digital services tax compliance will rely entirely on the willingness of companies to adhere, as proposed approaches come with an ambiguous set of allocation rules–such as where a user opens an account or sees an ad–that makes it hard to determine and track the tax obligation. Governments do not have the technology to monitor such activity, so the burden would be placed on businesses themselves.

The Global Impact

While the digital services tax currently targets American tech giants, it will soon no longer be just a U.S. challenge. The other side of the economic world and countries such as China are already anticipating the impact on their businesses, like the telecom giant Huawei or e-commerce company Alibaba, that have dominated the

When strong economies are disputing trade terms, products and services become too expensive for developing countries to afford – widening the technology gap. When a digital services tax drives costs up, smaller economies can't afford to innovate and compete. They are the ones that eventually pay the digital services tax price, along with consumers everywhere.

Conclusion

The digital services tax is not the right solution to capture tax revenue. At this time, we have yet to realize the real and long-term potential implications of the global digital economy. The international community needs to align on an effective universal and multilateral tax framework that follows sound fiscal and economic policy, as well as balance and neutrality. It must be designed to observe the already established international trade rules, either via treaty or WTO rules. It would also need to be inclusive of developed and developing economies. It should address capital, as well as technology import and export disparity, as opposed to aggravating inequality.

The digital services tax is certainly not the most efficient or applicable tax revenue model, as it is mostly based on a predetermined perception of uncooperative technology companies and not a factual, data-driven valuation of the economic activity and performance of select digital business models. The digital economy presents new and unique tax challenges for governments, businesses and consumers worldwide. Modern technologies require adapting existing regulatory frameworks, as well as the consideration or creation of new ones, to ensure that they are not exploited to negatively affect the global economy.

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