DIGITAL SERVICES TAXES
- AND ALTERNATIVES

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Why tax profit digital services in location of the user?

- “This measure is not expected to have any significant macroeconomic impacts”
  (UK Treasury)
- So a pure revenue grab: a “Sutton Tax”

Where do we tax profit now?

Based on 1920s compromise …

- Tax *active* income in the location of economic activity – the “*source*” country
- Tax passive income in the place of ownership – the “*residence*” country

Where do we tax profit now?

RESIDENCE OF SHAREHOLDERS	HEADQUARTERS / PARENT COMPANY	AFFILIATES	SALES
Worldwide	One location	Many locations	Worldwide
	US: GILTI	Mostly tax here	

How well does the existing system shape up?

- Economic efficiency – poor
- Robustness to avoidance – poor
- Ease of administration – very poor
- Incentive compatibility – poor

- *Fairness difficult to call*

UK Treasury position on digital services

“1.1 The international tax framework is underpinned by the principle that the profit of a multinational group should be taxed in the countries in which it creates value ...

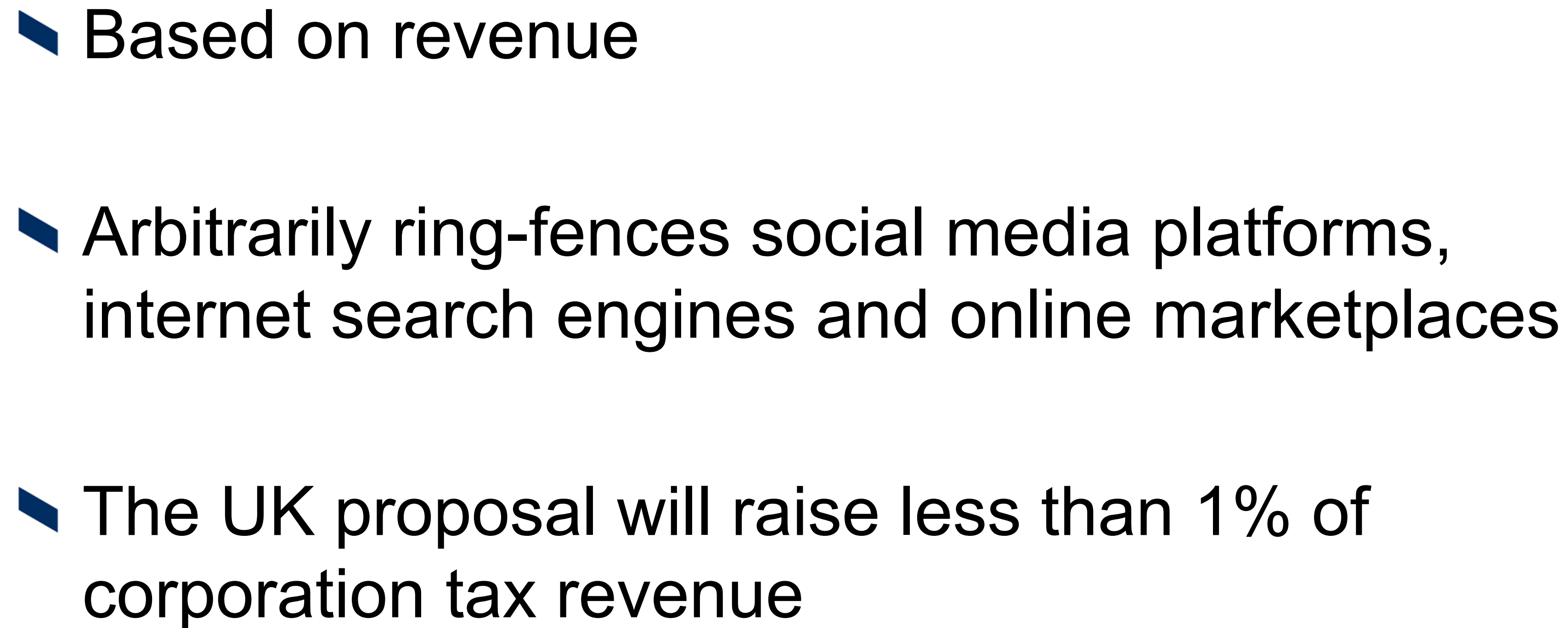
1.3 The UK continues to support that position.”

H.M. Treasury, Digital Services Tax: Consultation November 2018

Taxing where “value is created”

- Is NOT the basis of the current system
- Difficult or impossible to say where value is created
- A concept shoehorned into service of revenue collection

Some other issues with the DST



- Based on revenue
- Arbitrarily ring-fences social media platforms, internet search engines and online marketplaces
- The UK proposal will raise less than 1% of corporation tax revenue

A more coherent approach …

Gains on at least four criteria if tax base is **less mobile,** e.g. where consumers are resident

- *Economic efficiency*
- *Robustness to avoidance*
- *Ease of administration*
- *Incentive compatibility*

Fundamental reform options

RESIDENCE OF SHAREHOLDERS	**HEADQUARTERS / PARENT COMPANY**	**AFFILIATES**	**SALES**
Worldwide	**One location**	**Many locations**	**Worldwide**
			DBCFT
		RPAI	RPAI

A more coherent approach?

- Residual Profit Allocation by Income (RPAI)
- Allocate rights to tax routine profit to where functions and activities take place
- Allocate rights to tax residual profit to where sales are made

Fundamental reform options

RESIDENCE OF SHAREHOLDERS	HEADQUARTERS / PARENT COMPANY	AFFILIATES	SALES
Worldwide	**One location**	**Many locations**	**Worldwide**
			DBCFT
		RPAI	RPAI
	Pillar 2	Pillar 1 & 2	Pillar 1

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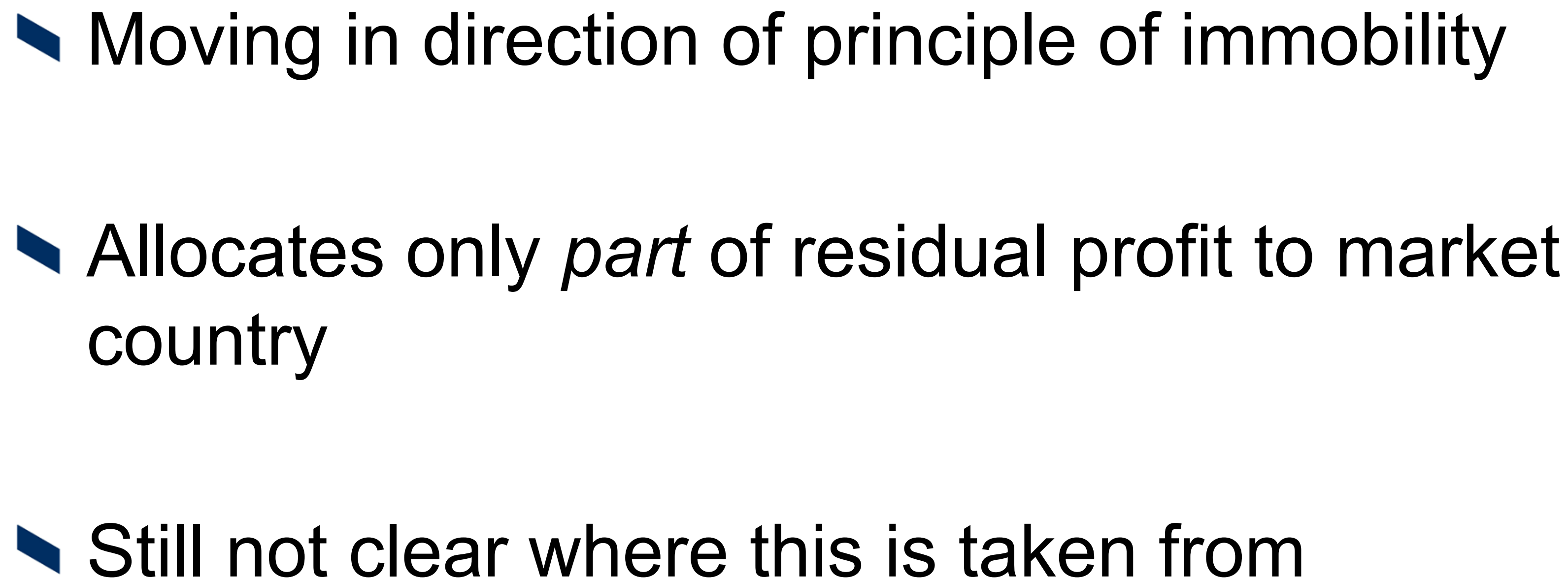
Pillar 1 – taxing residual profit in the market country



Pillar 2 – taxing residual profit in the market country

- Allocates taxing rights to the country of the parent (*income inclusion rule*)
- And may deny deduction for payments (*tax on base eroding payments)*

Pillar 2 – taxing residual profit in the market country

- Not consistent with principle of immobility
- Aiming to reduce profit shifting or tax competition?
  - OECD BEPS approach is: “no or low taxation is not *per se* a cause of concern, but it becomes so when it is associated with practices that *artificially segregate taxable income from the activities that generate it*.”

Concluding thoughts

- Moving towards taxing profit in the market country (or country of user) makes sense
  - And is arguably inevitable
  - DST is not the way to do it
  - Pillar 1 is a modest step in the right direction