

Digital Trade in Services and Taxation

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Executive Summary

Digitalization is prompting governments to review their taxation policies. Some have introduced digital services taxes, the effects of which are not yet clear.

With the rise of the digital economy there has been growing policy interest from governments and international organizations on various fronts, including taxation. Despite progress towards a consensus on international tax reform in the context of digitalization through the OECD/G20 Inclusive Framework, a number of countries have proposed and implemented digital services taxes (DSTs) on revenues from specified digital activities. It remains to be seen when and to what extent these will be removed in spite of recent high-level agreement to do so.

The World Economic Forum has conducted interviews and a survey with businesses facing DSTs as well as discussions with experts to

understand the incidence and impact of these measures so as to better inform policy decisions.

This white paper first discusses the rise and relevance of digital services trade and corresponding regulatory interest. After summarizing the main tax concerns and initiatives in the context of digitalization it shares insights on various aspects of DSTs and their effects before putting forward some considerations for policy-makers.

This preliminary inquiry into the effects of DSTs on trade, investment and competition highlights the need for further research, including in specific country and regional contexts as well as in relation to various business models and companies.



Introduction

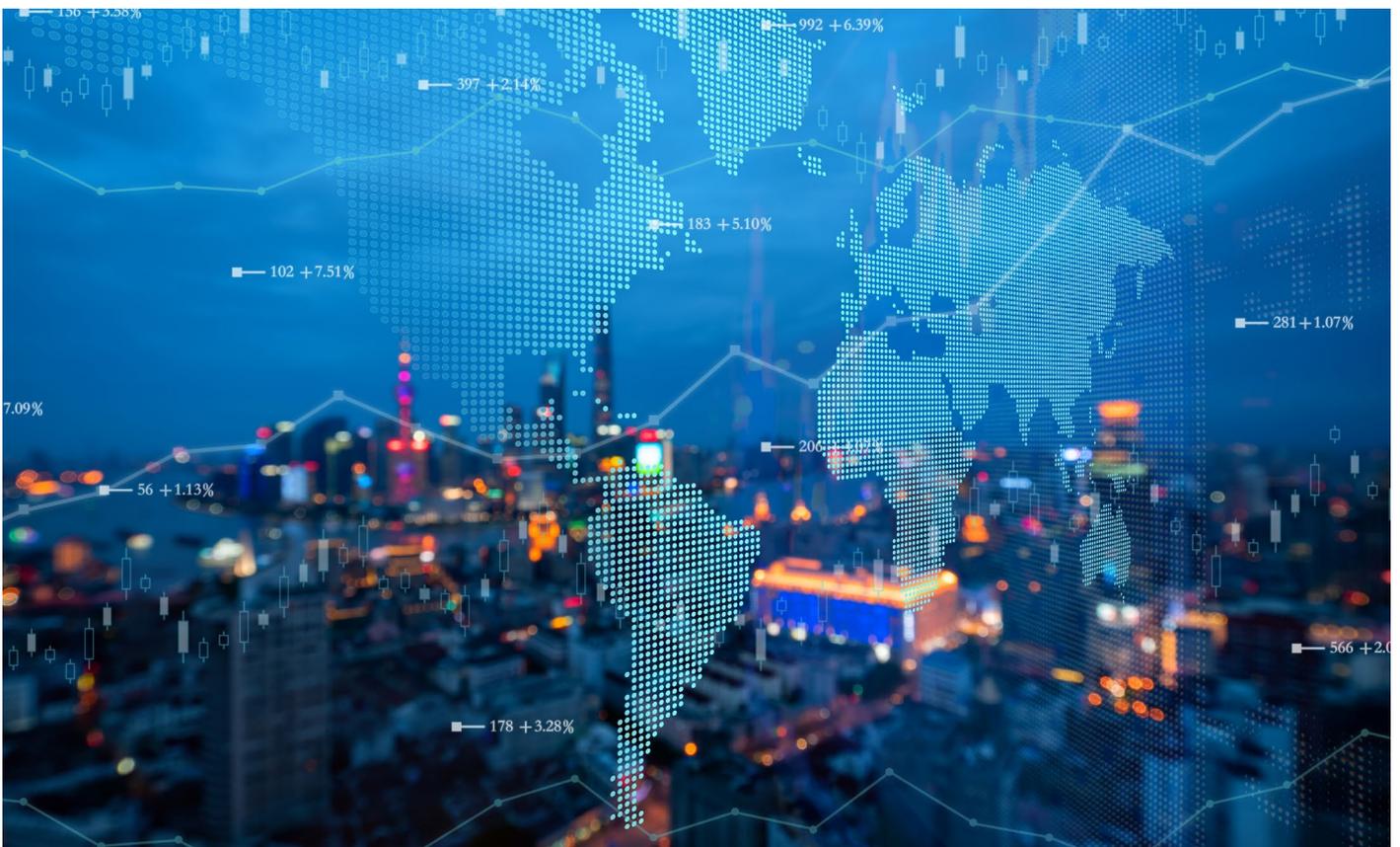
As governments consider how to tax in a digitalized economy, the incidence and impact of DSTs must be better understood.

The issue of how to effectively tax companies and activities in a digital economy has gained prominence. Global dialogue on corporate income tax reforms is underway through the Organisation for Economic Cooperation and Development (OECD)/G20 Inclusive Framework, various jurisdictions are considering and applying digital services taxes (DSTs), and value-added tax/goods and services tax (VAT/GST) are being revised for cross-border e-commerce and applied to digital goods¹ and services.

Considerable progress has been made through the Inclusive Framework negotiations, with a landmark high-level agreement reached on 1 July 2021², which states that new international tax rules will be applied in coordination with the repeal of all national DSTs. Implementation is targeted for 2023 and it remains to be seen when and to what extent these unilateral measures will be removed.

Meanwhile, information is scarce on the incidence and impact of DSTs on businesses and economies. These are relevant considerations for governments exploring DSTs, given the importance of cross-border digital services trade and digital innovation in the context of the COVID-19 pandemic and economic recovery.

The World Economic Forum has conducted a series of interviews and a global survey to understand how COVID-19 has affected digital trade and how tax policy changes in different countries affect business operations and decisions. Survey insights are based on 219 responses collected in July 2021 from businesses of varying size³ involved in digital sectors⁴ from around the world⁵. All respondents were from companies currently engaged in business abroad, serving clients overseas and as such potentially subject to digital taxes as they provide digital services or digital goods, sell goods or services through online channels or operate a digital platform. Survey insights are included throughout this paper.



1

Digital Trade in Services

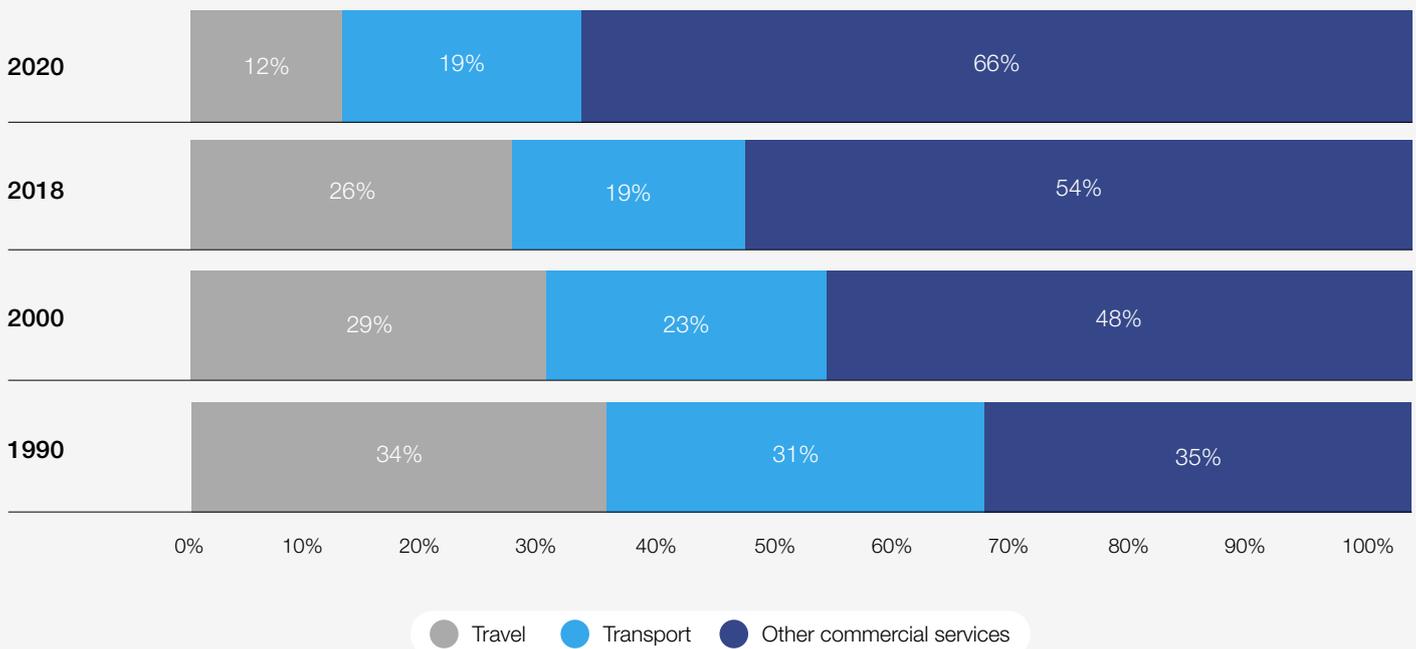
Trade in digital services has accelerated, particularly with COVID-19. While essential in keeping economies running, it has attracted much regulatory interest.

1.1 The rise of trade in digital services

Since the year 2000 and especially after 2011, the expansion of trade in services has outpaced that of trade in goods.⁶ While efforts to measure the volume and value of digital services specifically are at a nascent stage⁷, their trade surge is undeniable. Estimates in 2018, prior to the pandemic, suggested

that more than half of services traded could be delivered through digital means.⁸ Exports in “other commercial services”, which include several digital services that are subject to DSTs, have increased significantly, constituting one-third of services exports in 1990 and two-thirds in 2020 (Figure 1).

FIGURE 1 Other commercial services are gaining relevance in trade in services

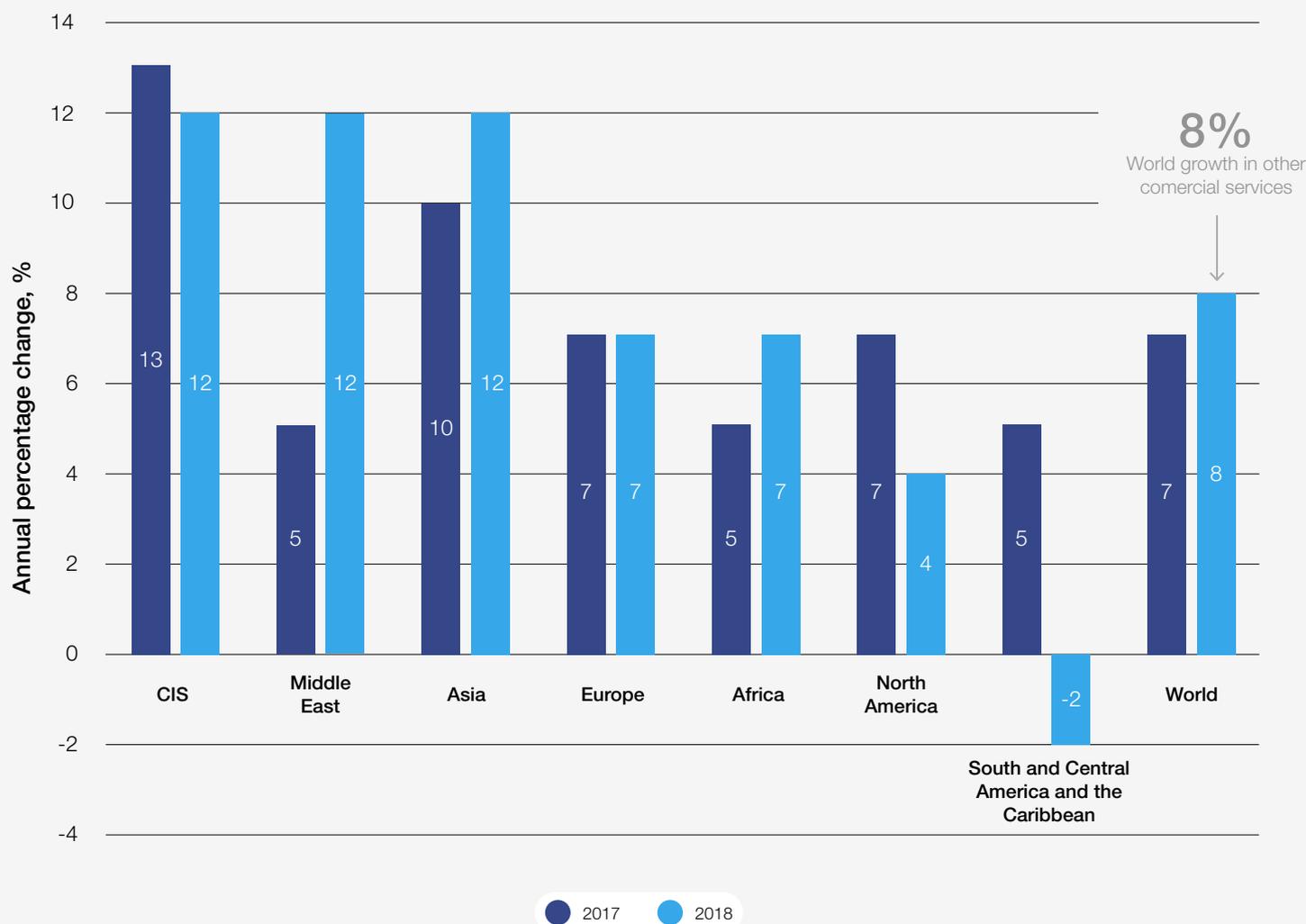


Source: World Bank, World Development Indicators, years 1990, 2000 and 2018; WTO-UNCTAD estimates, year 2020, cited in WTO, [World Trade Statistical Review 2021](#).

Almost all regions in the world have experienced an increase in exports in this category (Figure 2). In 2020, exports of computer and related services, for instance, saw double-digit growth in many economies across various regions. The economies

that registered the most rapid growth were Belize (78%), Japan (62%), Kazakhstan (51%), Myanmar (39%), Portugal (37%), Montenegro (37%), Pakistan (36%), Armenia (34%), Uruguay (30%), and Indonesia (28%), albeit from low starting points in some cases.⁹

FIGURE 2 | Growth of “other commercial services” exports by region, 2017 and 2018 (annual percentage change)



Source: WTO, [World Trade Statistical Review, 2019](#), p. 39, based on WTO-UNCTAD-ITC estimates.

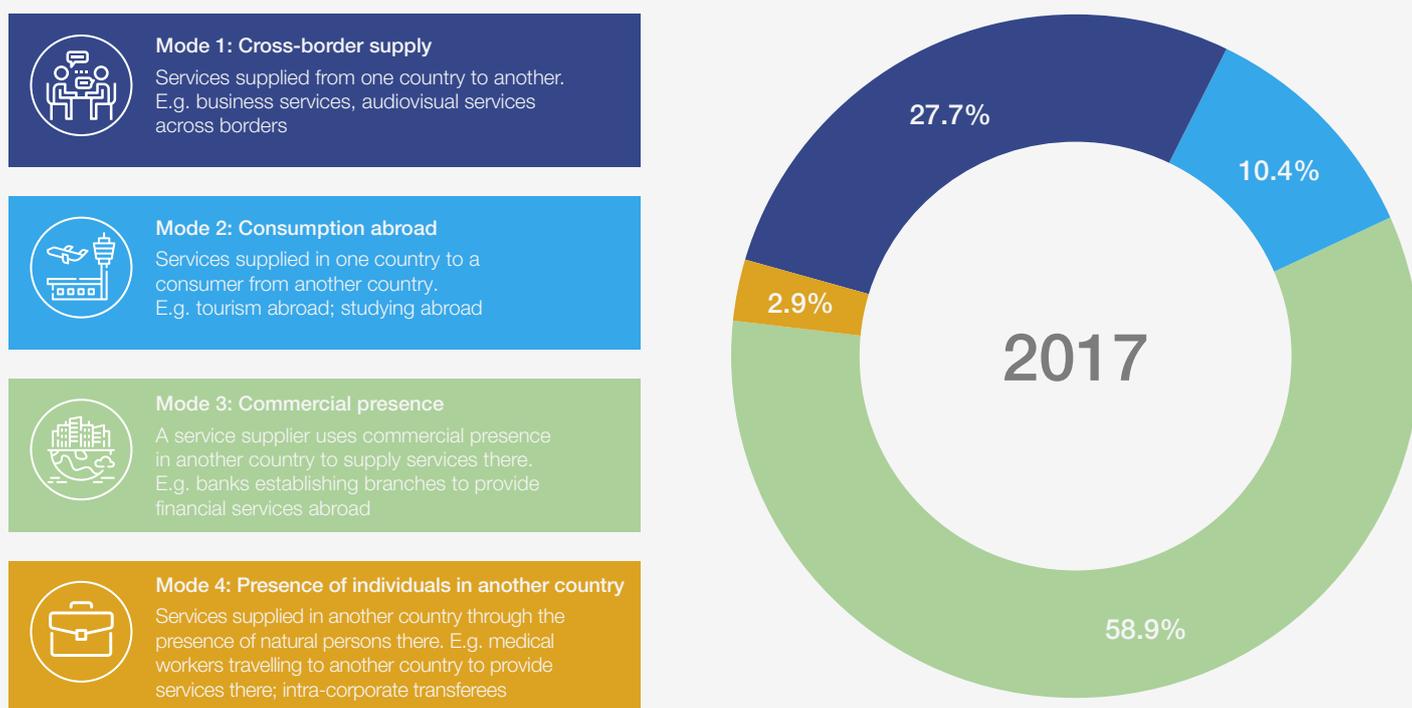
1.2 Relevance of digital services trade as a mode of supply and for MSMEs

Trade in services is conducted through four modes of supply. Cross-border supply (mode 1), including digital trade in services, amounted to \$3.7 trillion in 2017 and is second only to foreign direct investment in services or commercial presence (mode 3) (Figure 3). Digitalization is expanding the provision of services across borders, along with other modes of supply. Cross-border transactions delivered over ICT networks – internet, voice or data networks – have increased from \$1,855 billion in 2008 to \$2,954 billion in 2018 (1.6 times).¹⁰ During this period, developed countries accounted for three quarters of digitally deliverable services exports. However, the highest growth was seen in developing countries, especially in Asia.¹¹

Due to COVID-19, trade in services requiring physical proximity, such as construction services, and personal, cultural and recreational services, fell steeply in 2020,¹² while computer services, financial services, and insurance and pension services grew in 2020 by 8%, 4% and 3%, respectively.

Some of the most digital-intense services such as computer and information services, finance and insurance, as well as wholesale and retail trade experienced a surge in cross-border supply (over commercial presence) even before the pandemic.¹³ The relevance of cross-border digitally enabled services is likely to keep growing given changes in business operations and consumer behaviour amid lockdowns and travel restrictions.^{14,15}

FIGURE 3 | Trade in commercial services by mode of supply (2017)



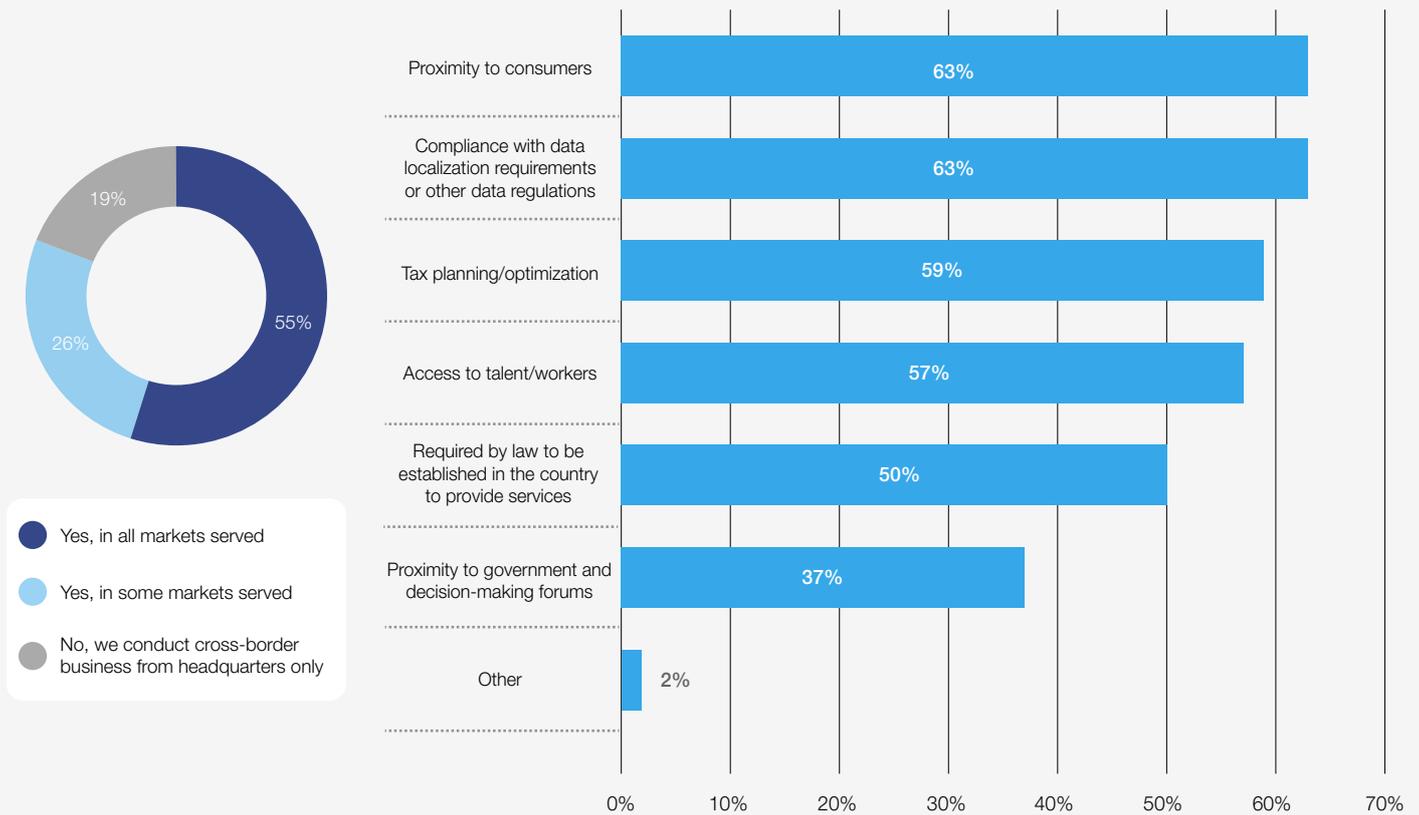
Source: WTO, World Trade Report 2019: The Future of Services Trade, 2019.
Note: World trade is calculated as the average of world exports and world imports.

With COVID-19 travel risks and restrictions, trade involving consumption abroad (mode 2) and worker movement (mode 4) are likely to suffer in the short- and mid-term. For instance, some institutions of higher education are facing a potential drop of 50 to 75% in international student enrolment.¹⁶ Further, many students are taking online courses offered by universities in countries other than their country of residence (mode 1) instead of travelling abroad to study (mode 2). Business and professional services are transitioning from face-to-face (mode 4) to virtual delivery (mode 1). The transition to electronic delivery will depend on a country's ICT infrastructure and digital skills, as well as on the nature of the service.

Digitally enabled services make trade more inclusive. Since they can be provided across borders, micro, small- and medium-sized enterprises (MSMEs) can tap into foreign markets

more easily without having to set up a commercial presence there. MSMEs tend to specialize in services as these are less capital intensive than manufacturing tasks. On average, MSMEs engaged in the services sector start exporting within four years, while those in manufacturing start within six years.¹⁷ Knowledge-intensive services, such as advertising, market research and professional services are particularly relevant.¹⁸ Digitalization is key to facilitating MSME participation in the international market, with digital platforms reducing structural disadvantages and allowing them to reach scale without mass.¹⁹ Yet, the Forum survey results suggest most digital companies still have commercial presence in some or all the foreign markets they serve.²⁰ Of these, well over half declare they are present in foreign markets to be closer to consumers, to comply with data localization requirements, for tax optimization purposes and/or to access talent.

FIGURE 4 | Commercial presence in foreign markets and reason for establishment



Source: World Economic Forum, Digital Services Trade and Taxation Business Survey, 2021, “Do you have a commercial presence/a physical office in the markets you serve?”; and “If you do have a commercial presence in some/all the markets you serve, what is the reason for establishment?”

Results show that some 19% of respondent companies do not have a commercial presence in foreign markets. Of these, 76% have fewer than 49 employees, highlighting the relevance of cross-

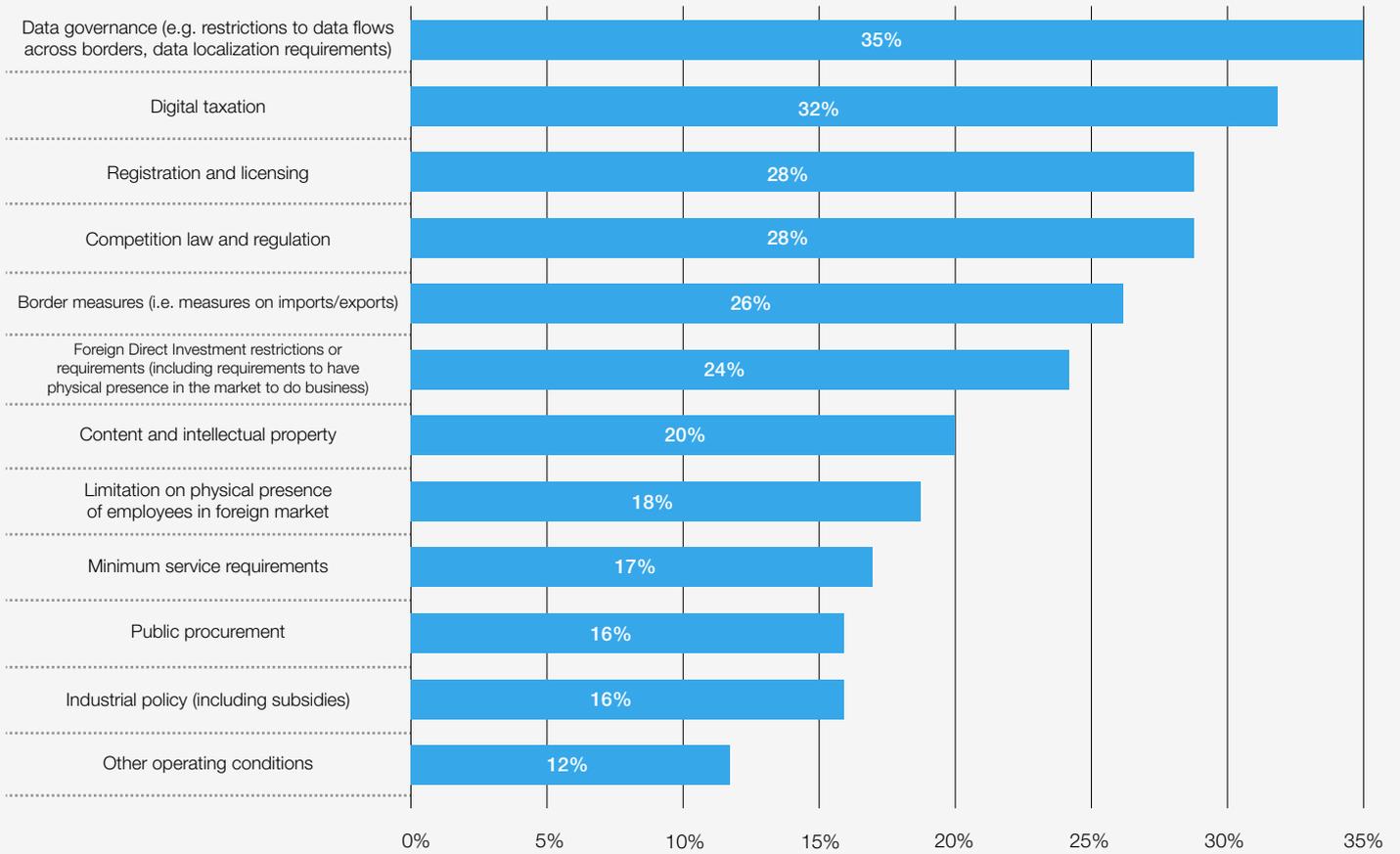
border supply (mode 1) for MSMEs. Conversely, 52% of those reporting a commercial presence in all markets they serve have more than 250 employees.

1.3 Growing regulatory interest

Digitalization has raised various economic policy challenges. Governments have enacted and updated regulation covering data flows and data localization, licensing, national security, privacy, cybersecurity, competition and taxation. The Digital Policy Alert database records the introduction or modification of over 650 policies or regulations in G20 countries affecting digital commerce between January 2020 and August 2021.²¹

Survey respondents identified data governance and digital taxation measures as top policy concerns for digital trade (Figure 5). Similarly, in a 2019 poll by PwC, 44% of large companies ranked taxes on digital services as one of the top three policies that affect their business as they conduct cross-border service delivery.²²

FIGURE 5 | Top policy concerns for digital trade



Source: World Economic Forum, Digital Services Trade and Taxation Business Survey, 2021, "What are your top three digital policy concerns/barriers when serving foreign markets?"

Domestic regulations can affect international trade and constitute *de facto* barriers to trade, even where not specifically targeting foreign companies.²³ For instance, requirements relating to legal presence, data storage, registration or tax identification in the foreign market can erode the advantages of supplying services remotely cross border. Smaller players in particular are less able to meet these additional requirements and costs.

According to the OECD, fixed costs associated with meeting foreign laws and regulations can represent up to 50% of total export revenue in the first year that a business starts exporting. This is more of a problem for MSMEs as they cannot afford temporary losses. Modest reductions in services trade restrictions can lower export costs for the smallest companies around 7.5% more than for larger ones.²⁴

2

A Changing Tax Landscape

Digital services taxes are one among various tax responses to the digitalization of the economy.

2.1 Tax concerns in the context of digitalization

Governments have expressed various tax policy concerns in the context of digitalization, even before the pandemic. These include government revenue losses and the unlevel playing field between digital and brick-and-mortar businesses created through:

- The ability of companies to engage in economic activities in a jurisdiction without establishing a physical presence there, which has been a traditional requirement for creating a nexus and thus being subject to corporate income tax

- The increasing volume of e-commerce parcels that are exempt from consumption taxes
- The digitalization of goods and services that are harder to capture through existing tax rules

In this context, the tax policy landscape has seen significant changes.

2.2 Corporate income tax

On 1 July 2021, over 130 countries reached a high-level agreement on reforming international corporate tax rules in the context of digitalization through the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS).²⁵ This statement sets out the agreed components of Pillar 1 and Pillar 2 (see below) and anticipates that outstanding issues will be resolved and a strategy for implementation developed in October 2021. The plan will cover model legislation, guidance and a multilateral treaty to be developed in 2022 implemented in 2023.²⁶

Pillar One: Pillar One aims to reallocate taxing rights among countries with respect to the profits of the

largest and most profitable multinationals (i.e. with global turnover above €20 billion and profitability above 10%). The OECD estimates that taxing rights on more than \$100 billion of profit will be reallocated to market jurisdictions (where users and customers are located) each year.²⁷

Pillar Two: Pillar Two aims to limit tax competition among countries to some degree by introducing a global minimum effective corporate tax of 15% through rules allowing other countries to charge a top-up tax where profits are taxed at less than the minimum elsewhere. This is estimated to bring in an additional \$150 billion in tax revenues annually.²⁸

BOX 1

Digital Permanent Establishment Rules

Some countries have introduced or considered digital permanent establishment rules to ensure that companies engaging in the economy remotely, without physical presence, are nevertheless deemed to have a permanent establishment in the country for the purpose of corporate income tax liability. For instance:

- A foreign supplier may be deemed by the Israeli Tax Authority to have "significant digital presence" in Israel based on the number of contracts

with Israeli customers, high use of services by Israeli customers, website adaptations to Israeli customers (language, currency), high volume of web traffic from Israel, etc.²⁹

- Indonesia requires foreign sellers and operators of e-commerce platforms to appoint a local representative in the country to pay and report taxes, including corporate income tax on the basis of a significant economic presence and an electronic transaction tax (not in effect)

on sales where the significant economic presence concept cannot be applied because of a tax treaty.³⁰

- The Indian Government introduced tax provisions related to significant economic presence (SEP) in 2018 to create a “business connection” for non-residents in the country. In May 2021, a notification clarified that there

is considered to be a SEP if a non-resident exceeds a revenue threshold of INR 20 million (\$280,000) in aggregate sales to Indian residents or has more than 300,000 Indian users.³¹

- In 2018, Slovakia expanded the definition of permanent establishment to include provision of recurring online intermediation services for transport and accommodation.³²

Separately, the UN Committee of Experts on International Cooperation in Tax Matters has drafted a new article which has been introduced into the UN Model Tax Convention that countries may use as a basis for negotiating bilateral tax treaties. Article 12B on “Income from Automated Digital Services” allows the jurisdiction in which the income arises to tax that income. If the beneficial

owner of the income is a resident of another state that is party to the bilateral tax treaty, the model provision proposes that a maximum rate of tax apply. The rate of tax is decided during the negotiation of the treaty. The provision does not apply to income connected with a permanent establishment or fixed base in the country in which the income arises.³³

2.3 Digital services taxes (DSTs)

“ 26 countries have enacted tax legislation in the form of DSTs, withholding taxes or digital permanent establishment rules.

While a multilateral solution was being negotiated through the OECD/G20 Inclusive Framework, some countries enacted domestic tax measures. As of August 2021, 26 countries have enacted direct tax legislation (in the form of DSTs, withholding taxes or the introduction of digital permanent establishment rules) and 15 others have laws pending.³⁴ Digital services taxes are typically not covered by tax treaties as they are not taxes on corporate income. They are considered by some to be a departure from established international tax principles as they tax gross revenues, regardless of whether profits are being made, and result in companies paying taxes in their export destination because that is

where consumers are located and where the services are consumed.

The 1 July 2021 high-level agreement states that the final solution will ensure that new international tax rules are applied as all DSTs and other similar measures are removed.³⁵ Members will need to agree on a definition of the measures they will eventually remove. Australia, Chile and Germany have withdrawn public announcements or proposals,³⁶ but it remains to be seen when and to what extent DSTs will be completely removed, particularly if they cover a wider set of companies than Pillar One.

2.4 Value-Added Tax (VAT) / Goods and Services Tax (GST)

Consumption taxes are levied on the purchase of goods and services at each stage of production and distribution (in the case of VAT) or at final sale (in the case of GST). These are borne by the final consumer as part of the product price paid, making them “indirect taxes”. In the case of traded goods, exports are exempt from VAT and imports are charged domestic VAT in the buyer’s jurisdiction. In the case of services supplied across borders, the place of taxation for VAT could be based on the place where the service is performed or the location of the seller, the buyer or the tangible property related to the service. The OECD’s International VAT/GST Guidelines recommend using the location of the buyer.³⁷

Applying VAT/GST to e-commerce

Governments are updating VAT/GST for international e-commerce. Countries have typically exempted small-value goods imports from VAT/GST because of the cost of collecting these at the border. A de minimis threshold indicates the value above which an imported good will incur customs and tax charges, including VAT. However, e-commerce has resulted in growing volumes of low-value imports, raising governmental concern about lost revenues and an unfair advantage for foreign sellers. Australia, for example, has introduced a system that requires foreign sellers that exceed A\$75,000 in sales a year to Australian buyers to register themselves

and remit GST.³⁸ Digital platforms are being expected in some cases to collect these taxes.³⁹

The EU updated its VAT rules from 1 July 2021 to increase revenues, combat fraud and level the playing field between foreign and EU sellers and between online and traditional sellers.⁴⁰

A new one-stop shop allows online sellers to register for, declare and pay VAT on distance sales of goods and services across all member states. Online platforms are tasked with record-

keeping functions and are deemed suppliers in some cases.⁴¹

Applying VAT/GST to digital goods and services

Governments are also expanding VAT/GST to include digital goods and services in efforts to accord physical and digital businesses, as well as national and foreign sellers, equal treatment. Foreign sellers need to register, file returns and collect and remit these taxes to the governments of countries where buyers are located.



3

Digital Services Taxes: An Overview

DSTs vary across countries, and their incidence and impacts are important for policymakers to consider.

3.1 Objectives, scope and design

DSTs are taxes on certain revenue streams of digital companies.⁴² In general, they are levied on digital services used in a country, regardless of their domestic or foreign origin. Over the last five or so years, DSTs have been initiated and

implemented by various countries, and even by a few states in the US.⁴³ A recent study suggests that the imposition of DSTs in some jurisdictions correlates with a deteriorating trade in digital services performance in previous years.⁴⁴

Objectives

Stated policy objectives have included ensuring the value that businesses derive from user participation is taken into account in international tax rules and that large multinationals proportionally contribute

to public services⁴⁵; preventing the erosion of tax bases, preserving social fairness and ensuring a level playing field for all businesses⁴⁶; as well as enabling economic recovery from COVID-19⁴⁷.

Scope

The scope of DSTs varies in terms of the types of revenue-generating activities targeted, how to determine whether the revenue is sourced locally, minimum revenue thresholds (local and global), whether the tax applies only to foreign providers and sectoral carve-outs.

Many DSTs target online advertising and marketing activities. The share of digital advertising in global advertising revenue has grown from 15% in 2010 to 38% in 2017. Meanwhile, the amount spent on newspaper advertising in the US fell from \$65.8 billion in 2000 to \$23.6 billion in 2014.⁵⁰

For instance, France's DST taxes revenues from 1) the provision of a digital interface and 2) targeted online advertising. In the UK, the DST covers revenues from providing search engines, social media services and online marketplaces to users in the UK.

Minimum global revenue thresholds are often set to ensure that companies taxed are of a certain scale. These differ across countries and even within the EU. While the majority of EU countries have a global revenue threshold of €750 million (\$879 million), the threshold in Hungary is HUF 100 million (\$332,000).⁵¹ Domestic revenue thresholds, set to ensure that companies within scope have a significant digital footprint in the country, vary from €3 million (\$3.48 million) in Spain to €25 million (\$29 million) in Austria and France and £25 million (\$34 million) in the UK.⁵²

Austria⁴⁸ and Hungary limit their DSTs to taxing online advertising revenues. In Turkey, the DST targets online services including digital advertising, sales of content such as music, video, apps and programmes online, services allowing such content to be consumed online and the operation of digital platforms where users interact with one another.⁴⁹

“ DSTs vary in terms of the types of activities targeted, minimum revenue thresholds, applicability to domestic providers and sectoral carve-outs.

TABLE 1 | Examples of DST variations in scope

	Implemented as of	Services taxed	Minimum revenue threshold	Carve-outs
France	1 January 2019	Provision of a digital interface; online advertising services	Global: €750 million National: €25 million	Digital interface provider sells goods/services it owns to users; digital interfaces primarily providing digital content, communication or payment services; certain financial services; services aimed at placement of targeted ads
Austria	January 2020	Online advertising	Global: €750 million National: €25 million	Revenues related to financial liabilities set by law excluded for the purpose of revenue thresholds
Turkey	March 2020	Online services including advertising; sales of audio, video and digital content or services allowing online consumption of such content; providing digital environments for user interaction	Global: €750 million National: TRY 20 million	Certain payment services, services linked to R&D conducted in Turkey
United Kingdom	1 April 2020	Social media services; search engines; online marketplaces	Global: £500 million National: £25 million	Financial services; provision of digital content; software and hardware sales; television and broadcasting services
Spain	January 2021	Online advertising; online intermediation services; sale of user data/data transfer services	Global: €750 million National: €3 million	Regulated financial services and income from data transfers by regulated financial entities

Source: Elke Asen, "[What European OECD Countries Are Doing about Digital Services Taxes](#)", Tax Foundation, 25 March 2021; EY, "[Turkey's 7.5% Digital Services Tax to be effective 1 March 2020](#)", 15 January 2020; EY, "[France issues comprehensive draft guidance on digital services tax](#)", 13 April 2020.

Design

DST rates vary from 1.5% in Poland, 2% in the UK, 3% in Spain and Italy to 7.5% in Turkey.⁵³ In Turkey, the President can adjust DST rate from 1% to 15%, for all or some types of digital services.⁵⁴

As some countries levy a withholding tax (WHT) applicable to the same sectors taxed under DST, double taxation might occur on revenue generated by the same digital services. This might be the case

in Turkey, where a 15% WHT applies to digital advertising payments to service providers and intermediaries.⁵⁵ The European Commission's 2018 DST proposal indicated that member states would allow businesses to deduct DST payments as costs for the purpose of assessing the corporate income tax base. This was intended to mitigate double taxation of the same revenues through corporate tax and DST.⁵⁶

3.2 Revenue estimates and administrative costs to tax administrations

In its 2020 DST proposal, the UK Government estimated the government revenue from the tax to be £70 million in 2019-2020, £280 million in 2020-2021, £390 million in 2021-2022, £425 million in 2022-2023, £465 million in 2023-2024 and £515 million in 2024-2025.⁵⁷ In its 2018 proposal, the European Commission estimated that a DST of 3% could generate €5 billion in revenues for member states per year.⁵⁸ The Independent Authority for Fiscal Responsibility of Spain estimated that revenues from its DST at €546 million-€968 million per year.⁵⁹ The Italian Government had estimated €708 million per year in revenues through its DST.⁶⁰

The efficiency of tax administrations can be measured by comparing the annual administrative costs incurred in collecting taxes to the net revenue brought in over the year (“cost of collection” ratio). This can also be used to assess the efficiency of a particular tax.⁶¹ The UK Government estimated that the administrative costs of setting up IT systems, introducing new processes and hiring staff to administer the DST would be £8 million.⁶² For developing countries, particularly those likely to collect less in government revenue, fixed and variable costs involved in setting up systems to store and analyse the data required, train personnel and develop the capacity to verify information submitted by taxpayers must be factored in.

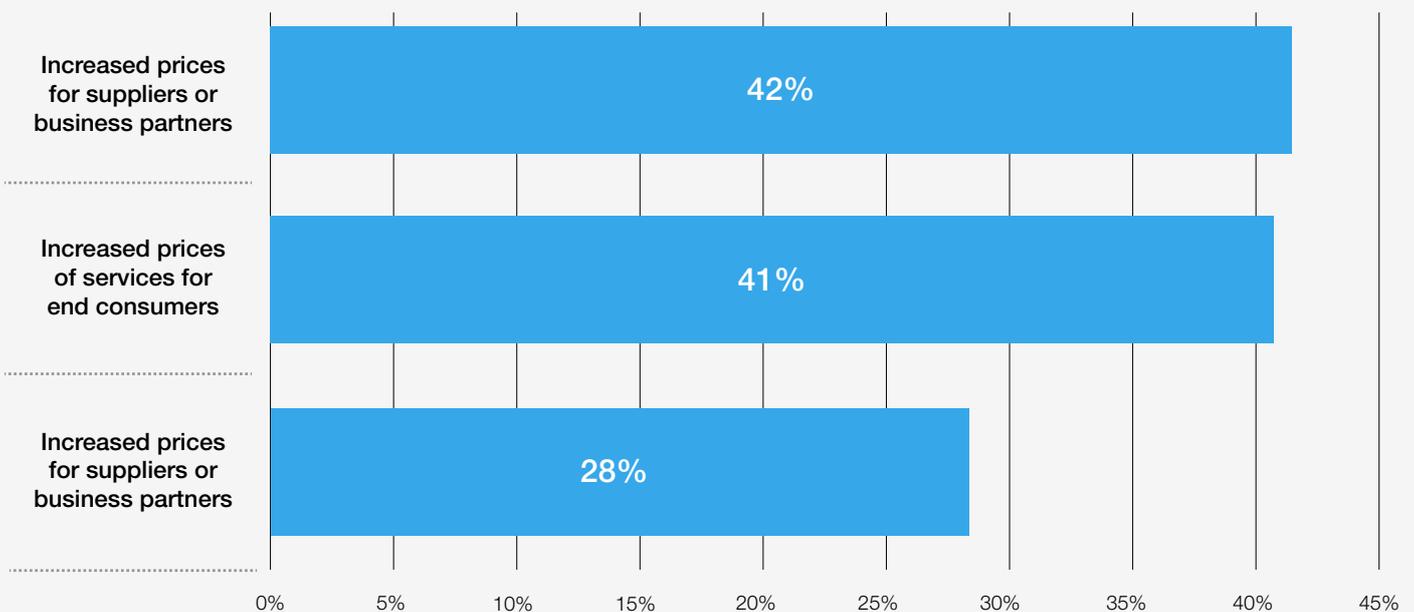
3.3 Incidence of the tax

One important consideration is tax incidence, or more specifically, which stakeholders bear the burden of DSTs. The competitive space in which companies operate will influence the incidence, and this may change in the long term. Some digital platforms, including Apple,⁶³ Google⁶⁴ and Amazon,⁶⁵ have said that they will pass costs on to app developers, advertisers and third-party sellers on their platforms, respectively, whereas others, like eBay⁶⁶ and Facebook⁶⁷, have said they will absorb the costs.

Around 40% of survey respondents said that DSTs cause them to increase prices for their suppliers and business partners and/or for their customers. Another 28% said they had to absorb the costs, as they were unable to pass them on (Figure 6).

Current literature suggests that DSTs may have a similar tax incidence as VAT does in raising prices for final consumers. Further, taxes on revenue or turnover are more likely to distort production decisions by businesses and to risk cascading or double taxation.⁶⁸

FIGURE 6 Who bears the cost of DSTs?



Source: World Economic Forum, Digital Services Trade and Taxation Business Survey, 2021, “How have digital services taxes affected your business?”

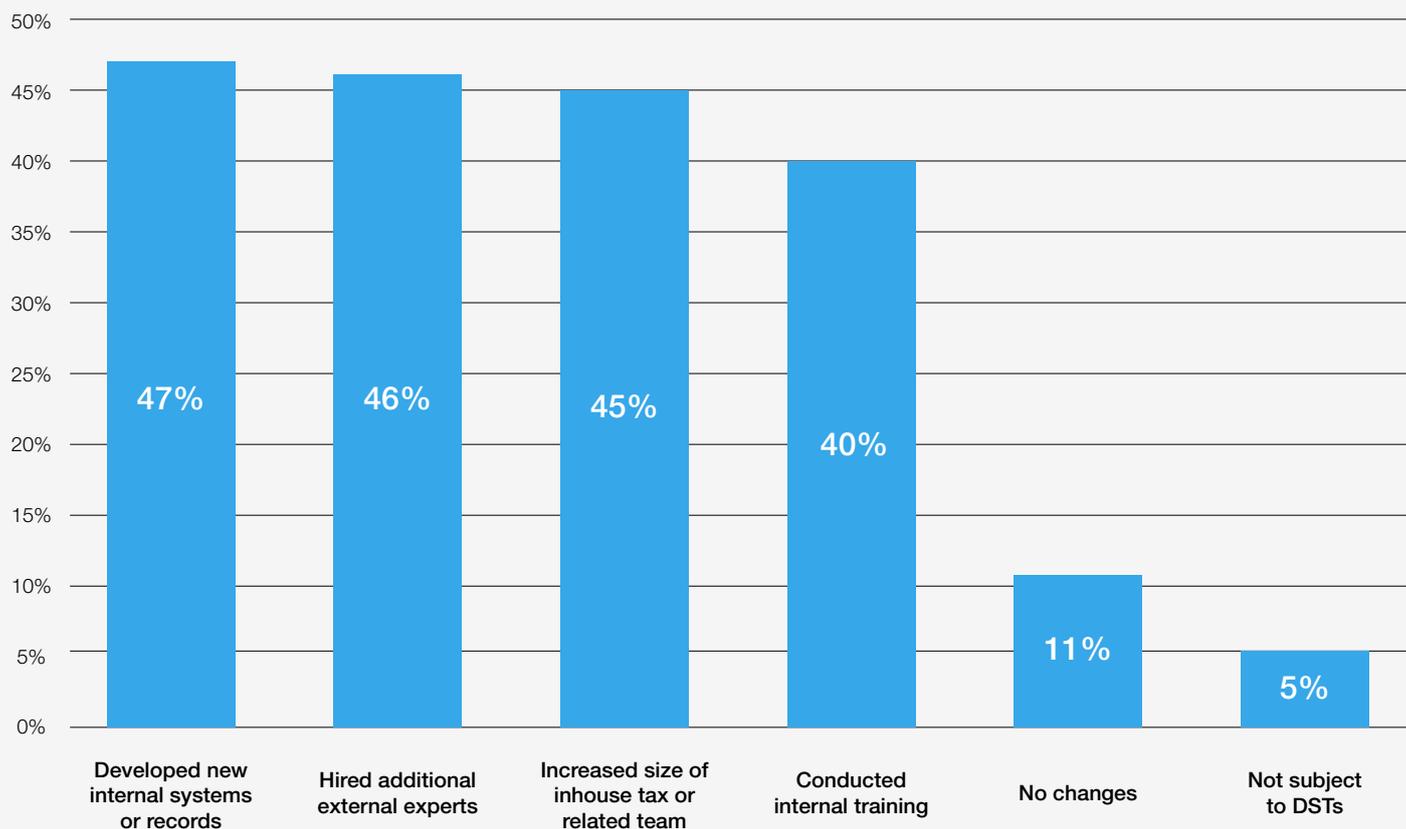
3.4 Impact on businesses

Costs

Aside from the DST itself, companies highlighted additional costs incurred such as in the hiring of external and internal tax, legal and accounting experts to deal with DSTs, setting up internal systems to track additional information required for reporting purposes, and conducting trainings.

Survey results indicate that 47% of respondents had to develop new internal systems or records, 46% hired external experts and 45% increased the size of their in-house tax and related teams. Only 11% of respondents said that they made none of these changes despite being subject to DSTs. (Figure 7)

FIGURE 7 Business response to multiple DSTs across jurisdictions



Source: World Economic Forum, Digital Services Trade and Taxation Business Survey, 2021, "How has your company responded to navigating multiple Digital Services Taxes across different jurisdictions? (Select all that apply)"

Information collection

Several businesses have raised concerns about the highly manual nature of the process of collecting the information needed to assess DST liability. Information that is not traditionally audited needs to be acquired based on digital activity that, often, does not constitute an economic transaction per se. For instance, in the UK DST rules, online advertising revenues are attributable to UK users when the a user views the advertisement.⁶⁹ However, the platform showing the advertisement may only get paid based on clicks or actual purchases by the user rather than just views or "impressions".

Some companies have reported shifting engineering manpower from product development to DST calculation. Additionally, calculation methods differ from country to country, making compliance efforts challenging even for big companies. One company reported spending 480 hours on the initial set up to comply with DSTs across several jurisdictions, while ongoing maintenance (data capturing and compliance) is roughly 1,000 hours annually.⁷⁰ Some of the information requested involves information that some companies interviewed do not collect for

business purposes. Tracking where users are “normally located”, based on evidence such as IP address, delivery address, payment details, intended destination of advertising, etc.⁷¹ can be challenging. Moreover, privacy concerns may arise in this regard.

Some experts note, however, that the re-design of the international and domestic corporate tax systems following the finalization and implementation of the OECD Inclusive Framework agreement will result in switching costs and the need to update reporting systems one way or the other.

Business decisions

Among survey respondents, 18% indicated that DSTs had led to their companies avoiding or exiting a market, at least temporarily.⁷⁴ One of the companies interviewed temporarily suspended the supply of a service to a market

applying a DST pending clarification on the application of the tax to the service. In general, however, the companies interviewed indicated that DSTs had not affected business decisions to serve a market.

3.5 Effects on trade, investment and competition

Trade

Measures targeting foreign providers

Few DSTs explicitly target only foreign suppliers of digital services. A proposal in 2018 to introduce a tax of 10% on digital services supplied by foreign platforms to customers in Chile was abandoned by the government in January 2020.⁷⁵ India introduced a 6% Equalisation Levy in 2016 on the gross amount of payments for certain services including online advertising in excess of INR 100,000 (\$1,500) per year from an Indian resident (or a non-resident with a permanent establishment in India) to non-residents without a significant economic presence (SEP) in the country. As of April 2020, a 2% levy applies to the amount received by a foreign e-commerce operator for selling or facilitating the sale of goods or services through e-commerce.⁷⁶

Where the indirect effect of the scope and design of the measure is to target only foreign providers through revenue thresholds, the types of activities in scope and carve-outs, international trade is affected by altering the conditions of competition between foreign and domestic services or service providers.

Increased costs on digital trade

Even where measures do not discriminate against foreign companies, international trade can be affected through increased costs.

Local registration, local agent and local presence requirements to supply services in a market are typically considered establishment

(or entry) barriers.⁷⁷ While trade agreements can include commitments to remove these, taxation is typically carved out of many trade commitments. Local representative or registration requirements associated with DSTs or other tax rules could undermine the ability of businesses to supply services cross border.⁷⁸

The concept of digital permanent establishment or digital services having a taxable nexus might undermine certainty around market access, as most WTO members have committed various sectors to market access via cross-border trade but kept restrictions on commercial presence.⁷⁹

Trade tensions and retaliation

One significant effect on trade that could be brought on by DSTs is caused by direct retaliation in response to what is perceived as a discriminatory measure (Box 2). In addition, the uncertainty caused by trade tensions has a dampening effect on trade and investment, as evident from the last few years.

The OECD estimated that global GDP would be negatively impacted between -0.1% and -0.2% in the scenario of “narrow” DST implementation and retaliation, that is, by countries under US Section 301 investigations. It evaluated a -0.4% to -1.2% effect in the event of DSTs being adopted more broadly and generating similar retaliation. The ranges reflect proportional retaliation at one end to retaliation at five-times the proportional level at the other.⁸⁰

The Office of the US Trade Representative (USTR) initiated a case under Section 301 (Trade Act of 1974) against the French DST, finding in December 2019 that the measure violated international tax principles.⁸¹ Tariff retaliation was threatened, but delayed when France agreed in January 2020 to suspend collection of the tax. However, in October 2020, France announced it would require digital companies to make tax payments in December 2020, given the absence of agreement at the OECD at the time.⁸²

In parallel, the US conducted an investigation against 10 other countries proposing and implementing DSTs⁸³ and found those that had been implemented to be actionable under Section 301⁸⁴. On 7 June 2021, the USTR issued notices of action imposing and immediately suspending for 180 days retaliatory duties against Austria, India, Italy, Spain, Turkey and the UK.⁸⁵

“ A stable tax system and tax certainty are important aspects of an enabling policy environment for foreign direct investment.

Investment

DSTs may not have been in force long enough to show visible direct effects on foreign investment. Most companies interviewed are not currently deciding to withdraw from certain markets or sectors, or reducing investment as a result of DST imposition. Some are waiting for tax changes to stabilize. It is important to note that tax experts at companies often reported not having a clear overview of how their company's investment decisions were affected by tax challenges or not being involved in investment-related decisions.⁸⁶

For some countries looking to attract technology companies and digital infrastructure, the potential effects of introducing a DST on inward investment is a concern. A statement from the Finance Ministers of Denmark, Finland and Sweden in response to the 2018 European Commission DST proposal raised concerns with respect to effects on innovation and R&D. “A system based on where the users are located must not reduce the incentives for states to provide a favourable climate for business.”⁸⁷

More generally, a stable tax system and tax certainty are important aspects of an enabling policy environment for foreign direct investment.⁸⁸ An OECD survey found that businesses considered tax certainty in corporate tax and VAT in investment and location decisions. Unclear tax administration practices, conflicting approaches among tax authorities and issues linked to dispute resolution mechanisms were identified as drivers of tax uncertainty.⁸⁹ The lack of clarity in the scope and implementation of many DSTs, as well as the inconsistent practice across jurisdictions was cited as a challenge by all companies interviewed.

Further, pursuing DSTs could undermine the consensus solution being reached through the OECD Inclusive Framework. Members have recognized that agreement is needed on both Pillars 1 and 2. Pillar 2, in particular, is likely to have profound effects on investment flows, as it limits tax competition among countries. Labour unions have highlighted the fact that this could elevate other factors, including labour costs and education levels, in foreign direct investment decisions.⁹⁰

Competition

Most DSTs target companies above specified revenue thresholds and supplying certain services, modifying the conditions of competition between them and other companies. As mentioned earlier, 42% of survey respondents reported that they raised prices for their suppliers or business partners, as did 41% for end consumers whereas 28% of respondents indicated they were unable to pass DST costs on to consumers or other actors in the supply chain – of which 35% are companies with fewer than 49 employees.

This raises questions about how DSTs will affect competition among platforms for suppliers, app developers, advertisers and customers in digital markets and what the knock-on effects for smaller or less profitable ecosystem players will be. Dominant platforms able to pass down the costs may have an advantage over new entrants. In that

sense, DSTs might reinforce the predominant positions of some companies. Even companies with global digital footprints but relatively lower profit margins might need to absorb the cost of DSTs as they need to compete for a small available share in a dynamic digital market, such as digital advertising.

From the 11% that report no effect of DST on their business, the majority are smaller players. This is understandable given that most DSTs have revenue thresholds meant to exclude smaller companies. Yet, MSMEs are likely to be indirectly impacted by companies that are able to pass on DST costs.

The effects on the conditions of competition in platform ecosystems should be seen in the context of efforts to regulate digital platforms and competition in these markets.

Policy Considerations

Governments can learn from each other's experience in designing DSTs or considering complementary or alternative approaches.

Most countries that have adopted or proposed digital services taxes have acknowledged they are a second-best policy, some introducing them as interim measures awaiting a multilateral solution. This section discusses considerations that policy-makers may take into account when deciding whether or how to introduce a DST.

In 1998, through the Ottawa Taxation Framework Conditions, the OECD Committee on Fiscal Affairs identified the five principles listed below to guide governments in the context of electronic commerce.⁹¹

- **Neutrality:** Taxation that is neutral and equitable among different forms of e-commerce and between e-commerce and traditional commerce allows business to make decisions on the basis of economic considerations. Similarly situated taxpayers and those involved in similar transactions are treated similarly.

- **Efficiency:** Compliance costs for taxpayers and administrative costs for tax authorities should be minimized.
- **Certainty and simplicity:** The tax must be administered through rules that are clear, simple and allow taxpayers to anticipate the tax liability arising from a transaction.
- **Effectiveness and fairness:** Taxation ought to “produce the right amount of tax at the right time”, reducing the chance of tax evasion and tax avoidance and including proportionate measures to counteract them.
- **Flexibility:** Tax systems should be dynamic and adaptable to new technological and business developments.

DSTs may not fare well against some of these principles.⁹² Yet, as some countries may feel compelled to impose DSTs, the following considerations may help improve design and implementation.

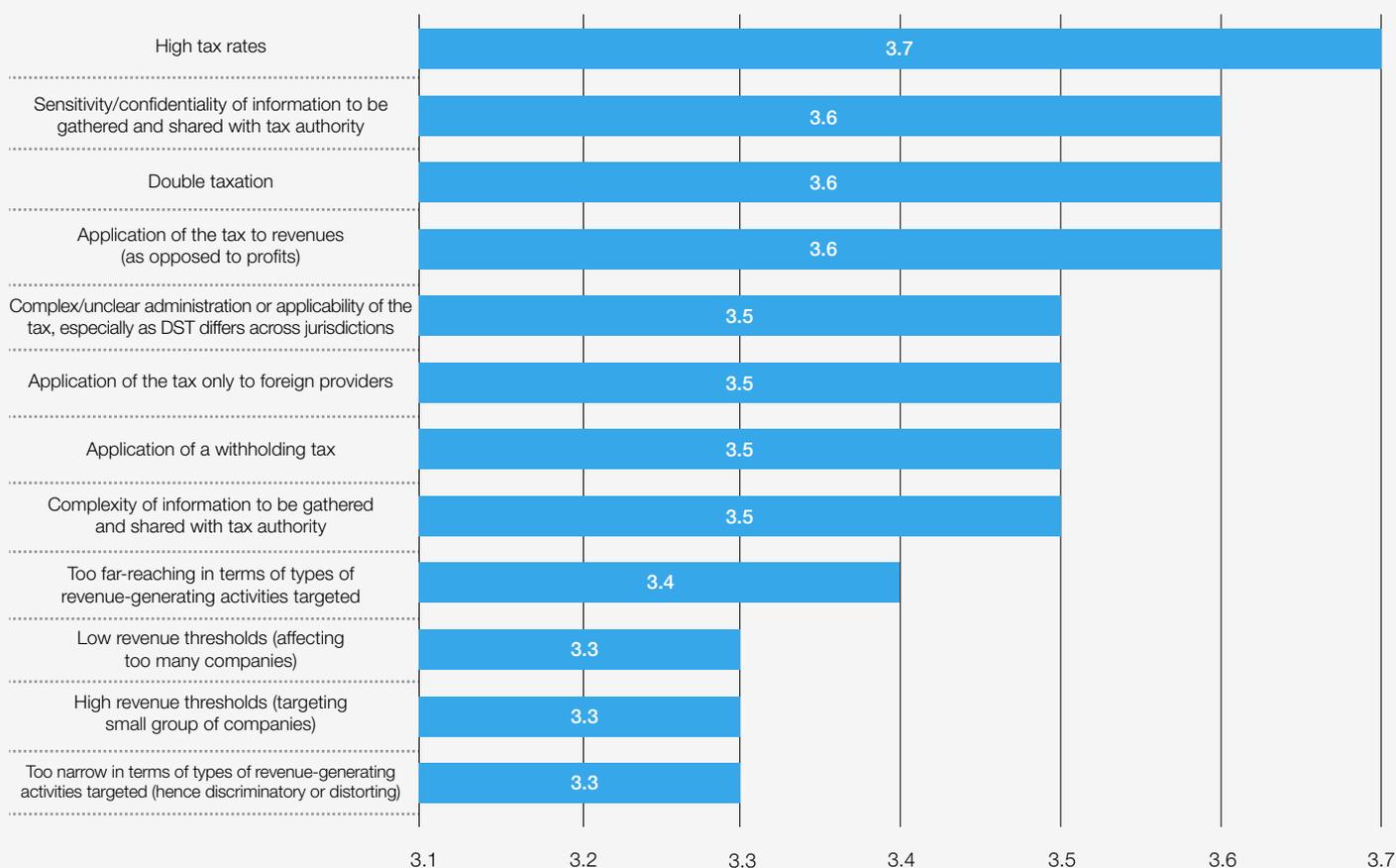


4.1 Improving the design and implementation of DSTs

The Forum survey results show that, aside from the tax rate itself, companies seem to be particularly concerned about the sensitivity or

confidentiality of the information requested, double taxation and the application of the tax to revenues (as opposed to profits).

FIGURE 8 DST aspects of particular concern to companies surveyed (average, 1-5 rating)



Source: World Economic Forum, Digital Services Trade and Taxation Business Survey, 2021, "What aspects of digital services taxes are of particular concern to your organization? Please rate from 1 to 5 (1 – of low concern; 5 – of serious concern)."

Survey and interview responses suggest that the following aspects are relevant to the design and implementation of DSTs:

Neutrality

- By their nature and purpose, DSTs target digital services and the companies that supply them and so are not neutral between digital and traditional activities. Other aspects of neutrality, however, such as how evenly they apply to foreign and domestic businesses, could be better considered. While few measures explicitly target foreign suppliers, some may appear (from the types of services selected or revenue thresholds applied) to fall primarily on foreign companies, as the USTR found in its section 301 reports on various DSTs.⁹³

- While the principle of neutrality also implies that taxes on a broader range of services and a lower revenue threshold are preferable as they are less distortive, this needs to be balanced with the concern that smaller players will face considerable difficulty complying with reporting and payment obligations. Because the tax is based on gross revenues, companies with higher profit margins will face a lower effective tax burden compared to a company with thinner margins.

Efficiency

- Compliance costs could be kept low by rethinking the kind of information requested of businesses for reporting purposes. Requirements to provide business-sensitive

information and consumer data that may give rise to privacy concerns should be reconsidered. Information that is not collected in the usual course of business and would entail setting up expensive new internal systems could disadvantage relatively smaller players.

- Many businesses have been reported to be taking conservative (higher) estimates of tax liability under DSTs due to the uncertainty involved and not wanting to be seen to be litigious. This can lock them in to paying higher amounts in successive reporting periods.
- Administrative costs for tax authorities are likely to be high in terms of data storage costs and the training, personnel and systems needed to verify information submitted by taxpayers.

Certainty and simplicity

- More certainty is required in most cases, particularly in clarifying the digital services and businesses in scope, especially as these evolve and business models vary.
- Greater coherence between DST practices in different countries could reduce the complexities and related costs of assessing

tax liability and reporting requirements. There has been little by way of sharing best practices or common approaches, aside from some regional initiatives.⁹⁴

Effectiveness and fairness

- As DSTs are not covered by most bilateral tax treaties, there is a high chance of double taxation on income. DSTs could be designed to attempt to mitigate this through some form of relief where revenues are subject to multiple DSTs.
- Some interviewees raised concerns regarding the applicability of certain DSTs to activities that did not generate revenue. This could be better clarified in the rules if the intent is to exclude such activities.

Flexibility

- DSTs may be rigid, as most list specific digital services considered within scope and do not account for changes in business models, and which may be most significant in the future. Many DSTs are designed or declared to be temporary measures, so this may not be as valid a concern.

BOX 3

WTO law and national DSTs

WTO agreements do not impose obligations regarding how governments impose or collect taxes. However, trade rules relating to non-discrimination, both most-favoured nation (MFN) and national treatment (NT), obligations do apply. Whether a DST violates the non-discrimination principle under the General Agreement on Trade in Services will depend on the commitments that the Member imposing it has included in its Schedule, including whether the relevant sector is included in its NT commitments. GATS Article XVII covering NT explains that treatment that is identical in form may still be discriminatory “if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member”. This is a key consideration in terms of how DST compliance requirements fall, in practice, over domestic vs. foreign suppliers. If there is no *de jure* discrimination, it remains to be seen, case by case, how readily *de facto* discrimination

might be provable. Here, the design of the DST, including whether the thresholds, services covered and carve-outs exclude domestic companies, will be relevant. The general exception clause allows differential treatment for the purpose of equitably or effectively applying or collecting direct taxes.

The World Trade Organization’s plurilateral e-commerce negotiations do not specifically deal with DSTs. A WTO moratorium on imposing customs duties on electronic transmissions continues to be extended on a temporary basis, and the question of making it permanent is on the agenda in the plurilateral e-commerce negotiations, as is the question of how to effectively apply VAT/GST to small e-commerce shipments of goods and at what threshold level. Yet, even comprehensive digital trade agreements, such as the Digital Economy Partnership Agreement (DEPA), carve out taxation when including language that prohibits customs duties on electronic transmissions.

Source: Low, Patrick, “Digital services taxes, trade and development”, University of Adelaide Institute for International Trade, Working paper no. 2020-07, December 2020; Hufbauer, Gary Clyde and Zhiyao (Lucy) Lu, “The European Union’s Proposed Digital Services Tax: A De Facto Tariff”, Peterson Institute for International Economics, June 2018.

4.2 Alternative proposals

Other approaches have been proposed and implemented in the place of – and sometimes alongside – DSTs. Their merits and shortcomings are dealt with in more detail in other works.⁹⁵ Government, academic, consumer and civil society perspectives on the effects of these alternatives are of central importance.

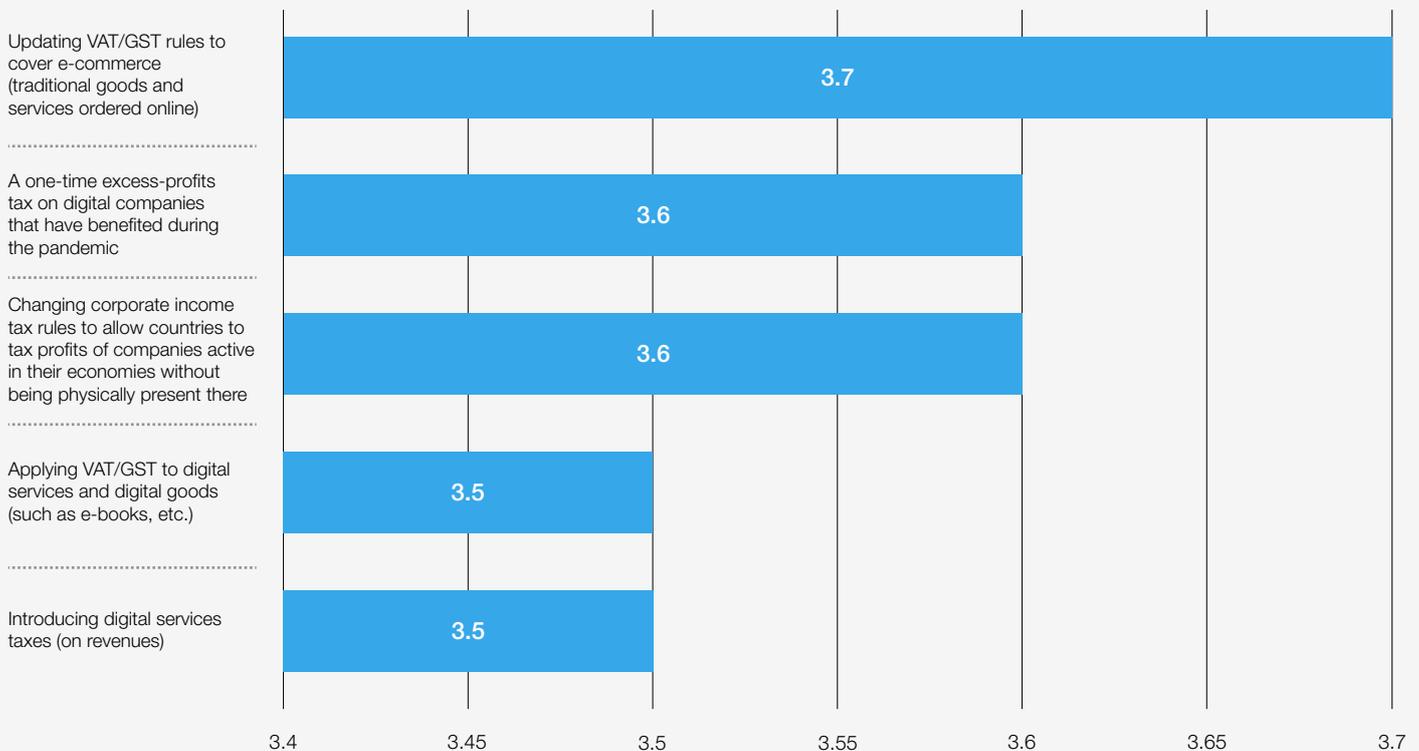
To complement these views, the survey sought input from respondents on which measures governments under public pressure to tax digital activities and companies should prioritize. The most preferable alternative identified was updating **VAT/GST rules to cover e-commerce of goods and services ordered online**. The majority of respondents are subject to VAT/GST more generally,

suggesting these taxes might be preferable in terms of compliance and cost efficiency, even if expanded.

A one-time **excess-profits tax** on digital companies that have benefited during the pandemic also received some support. This acknowledges the asymmetric impact of the pandemic on the number of digital compared to brick-and-mortar businesses.

There was a similar level of support for changing **corporate income tax rules** to allow countries to tax profits of companies active in their markets without being physically present there, in line with the OECD Inclusive Framework high-level agreement of 1 July 2021.

FIGURE 9 Tax changes most preferable (average, rating 1-5)



Applying **VAT/GST to digital goods and services** aims to extend existing taxes on traditional goods and services to digitalized format. Chile, for instance, withdrew a 2018 proposal for a 10% DST in January 2020 and enacted legislation effective 1 June 2020 requiring non-resident sellers of digital services to the Chilean market to register for and collect VAT at the country's regular rate of 19%.⁹⁶

Certain requirements in VAT/GST rules could necessitate or lead to a local presence, undermining commitments in trade agreements that prohibit requiring local presence to provide services in the

market.⁹⁷ Trade agreements typically exempt tax measures from the scope of commitments, and so the risk is not of a treaty breach but of taking away some of the benefits expected from the prohibition of local presence requirements. This impedes pure cross-border delivery of services (mode 1).

Due to the complexities involved, smaller service providers may rely on larger companies, including platforms, to provide these services for a fee instead of selling through their own online stores.⁹⁸ This could in turn increase their dependency on large platforms.

Conclusion

Concerns regarding government revenues for funding the recovery must be weighed against the various effects of DSTs on economies.

As all governments seek to finance policies aimed at economic recovery, there are genuine concerns, particularly in developing countries, about tax revenues. The question of how to tax a digitalizing economy is a complex one, and decisions on whether to impose DSTs are made harder by the lack of evidence regarding their incidence and impacts. This paper represents a preliminary inquiry into these questions; more evidence is needed.

Recurring challenges regarding DSTs included complex or unclear rules, onerous reporting

requirements and differences across jurisdictions, which could be facilitated through better coordination and exchange between countries.

In the absence of this, there will be increased costs on digital services trade, uncertainty that may affect investment in the long term and unintended effects on smaller players in digital ecosystems. As digital services grow in all regions of the world and support MSMEs and large parts of the economy through the pandemic and recovery, this is an important consideration.



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Endnotes

1. There is no internationally agreed definition for “digital goods”. The UN Central Product Classification (CPC) system defines the products in question as services. This paper does not discuss whether these are goods or services nor, consequently, whether the General Agreement on Tariffs and Trade (GATT) or General Agreement on Trade in Services (GATS) applies.
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