The Daily Dish

Digital Services Taxes

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Eakinomics: Digital Services Taxes

Yesterday Eakinomics reviewed the flawed policy foundations of the European Union's Digital Services Act (DSA). Today's topic is its close cousin, the Dismal, er, Digital Services Tax (DST). Gordon Gray and Jennifer Huddleston have a complete description. DSTs are taxes imposed on multinational firms on the basis of their digital activities in a particular jurisdiction. So, for example, the French DST is 3 percent of the gross revenue (above a certain threshold) earned *in France* by digital intermediaries (e.g. Amazon). (The precise definition of the tax base differs from jurisdiction to jurisdiction.) But what does it mean to be earned "in France?" After all, the point of digital activities is to have them be location-free. The answer is that it is based on the number of French users.

This is a problem. The prevailing norms in international taxation typically preclude taxing foreign firms without a permanent presence or "nexus" in a given tax authority's jurisdiction. Under the usual rules, a U.S. digital entity would have its net income taxed in the United States. The French DST, for example, turns out to be a pure money grab by the French from the U.S. Treasury. Why? U.S. firms are granted a dollar-for-dollar credit against their U.S. tax for any taxes paid to another country. So, $100 of DST generates $100 to the French Treasury and an offsetting $100 reduction in tax receipts by the U.S. Treasury. The right solution is to have a multilateral agreement on where the income should be taxed.

The problem is getting larger every day. As of March 2021, 26 nations (and the People's Republic of Maryland !) had DSTs or similar direct taxes. Fifteen additional nations have announced or otherwise proposed similar tax policies, while seven nations, including the United States, have announced they would await a multilateral solution. All of these DSTs were put in place in the last five years. This rapid proliferation suggests that there will be real difficulty reaching an agreement, because eight years ago the Organisation of Economic Co-operation and Development launched an initiative to make sure that all income was taxed once, but not twice. The first agenda item of the so-called Base Erosion and Profit Shifting (BEPS) effort was taxing the digital economy. Clearly, little progress has been made.

This is hardly just a matter of which country gets the money. Gray and Huddleston note that "The costs of such taxes are likely to be passed on to consumers and result in increased prices for beneficial internet services, such as advertising and third-party marketplaces, used by small businesses." DSTs are an unjustified distortion of digital markets under the guise of going after U.S. tech giants.

Cleaning up the DST mess should be a top priority of the Biden Treasury.