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EU digital tax proposal: updating tax rules for the 21st century

Oxfam analysis and background

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The European Commission has today presented proposals for new rules to tax the activity of businesses in the digital economy. It proposes a short-term solution to ensure large digital companies pay a minimum level of tax, and a long-term solution that aims to ensure the tax system is fit for purpose in our digitalized age.

Oxfam supports the idea of adapting our tax system to meet the challenges of a digitalized economy. This is not just about a handful of big tech firms. Technology is changing the way every single industry operates and the tax system needs to change to keep pace.

Here is an overview of what is at stake.

Why do we need a tax for the digital economy?

According to the European Commission, digital businesses – that is companies whose main services are provided online – pay an average effective tax rate of just 9.5 percent, compared with the 23.3 percent that traditional businesses pay. For our tax system to be sustainable, every company must pay their fair share of tax.

This means reforming our tax system so it meets the challenges of a rapidly digitalizing economy. The current international tax system was developed in the 1920s, with rules for an economy based on trade in goods and not trade in services and 'intangibles' like copyright, patents or brand value.

Major tax scandals over the past few years have shown that it has never been easier for large multinationals to virtually locate their operations in jurisdictions where the corporate tax system is more favorable, even if companies still have physical stores, factories, or warehouses in other countries.

The tax question of the 21st century is: where should profits be taxed? A fair answer to that question is: where profits are actually made. To ensure this happens in digitalized economy corporate tax rules must cover services and intangible assets such as copyright, patents and brand.

What does the Commission propose?

After a push from several EU member states last September (France, Germany, Spain, Italy and the UK), the EU has presented an action plan to tax the digital economy. This action plan includes two directives:

1. **A long-term solution** reflecting what the EU wants at international level, also called the 'comprehensive solution'. The directive aims to address situations where companies offer digital services in a country, but member states cannot tax those activities, because the firms do not have a physical presence in that country (also known as a 'permanent establishment').

2. **A short-term solution**, also called the "targeted solution": an interim measure to focus on the most pressing needs identified by the EU and its member states. It proposes a 3 percent tax on gross revenues (a turnover tax) based on where a company's users are located rather than where its headquarters is. This tax would apply to approximately 120-150 big tech companies that generate at least €50 million of taxable revenue inside the EU, and have a global turnover of more than €750 million.

What do you think of the proposed long-term solution?

Oxfam welcomes the EU's acknowledgement that the digital economy means we need to change the way we tax corporations, and that it is seeking a long-term solution to ensure international tax rules are fit for purpose in today's economy. However, Oxfam believes that we need a global solution to this global

challenge. Tax rules with global impact should not be made by a club of rich nations. All countries, including developing countries, should get a say in how we redefine international tax rules.

Right now, multinational firms can choose where to pay their taxes. By channeling their profits to a tax haven, they pay minimal or no taxes, even if the profits, services or products themselves are sold in other countries. This is why a global tax system is needed that treats multinationals as global companies from a tax perspective.

The long-term solution proposed by the EU Commission is a step in the right direction, because it focuses on the digitalization of the entire economy and not just the tech sector. It could have a positive impact on some of the poorest countries in the world, who lose billions of euros in tax revenue due to the current outdated international tax system. These countries often have little or no taxing rights over the huge profits companies generate providing digital services to customers in their countries. This lost revenue means health clinics are not built, teachers are not employed and developing countries are denied the means to tackle poverty and inequality.

What do you think of the proposed short-term solution?

There are significant problems with the short-term solution proposed by the Commission.

The measures proposed by the Commission – including a 3-percent turnover tax on tech giants – only target a handful of big tech companies, and will not prevent businesses exploiting our outdated tax system to systematically dodge billions of euros in tax every year.

There are also concerns that governments will focus all their energy on delivering short term 'headline grabbing' wins at the expense of making progress on the long-term solutions that will deliver lasting change.

Is this all about a handful of big tech companies?

No. It is true that tech giants' tax avoidance strategies have often made the headlines, and the European Commission estimates that digital businesses pay an average effective tax rate of just 9.5 percent, compared with the 23.3 percent that traditional businesses pay. However, it is important to note that the entire economy is currently being digitalized. Even companies in more traditional sectors can quickly shift their profits or relocate intangible assets such as patents to tax havens in order to avoid paying their fair share of tax.

The threshold and scope of the short-term proposal would target companies everywhere – in the US, in Europe or elsewhere. The proposal does not target US tech groups only, but concerns approximately 120-150 companies around the world. According to the European Commission, roughly half of the firms are from the United States, and a third are from Europe.

The long-term proposal, in particular, should aim to better define where profits are actually made and where they should be taxed

Can the EU alone really tax global tech giants?

Taxing the digital economy (and not only tech giants) has been on the agenda of the G20 group of nations and of the club of the world's richest countries, the OECD, for a long time. The issue was also discussed in 2015 as part of a global tax reforms package known as 'BEPS' but countries have been unable to agree a way forward. Oxfam is glad to see that the EU recognizes that this is an unsolved problem, and is showing political leadership on this important issue.

The European Commission legitimately argues that the EU needs a coordinated approach to taxing the digital economy to avoid different digital tax systems in each EU member state that would generate more tensions and disruption of the European Single Market. Nevertheless, these issues should be dealt with at a global level, involving rich and poor nations alike to find solutions that work for people across the globe.

What about the G20 and OECD work on digital taxation?

Last Friday, the OECD published its interim report on taxing the digital economy as requested by G20 finance ministers. Although 113 countries agree that the tax rules should be urgently updated, there is a clear lack of consensus when it comes to finding long-term solutions. It is therefore important that the EU moves on digital taxation, however it must work with governments on a global level to make sure developing countries also get a say in the tax rules for the digital economy.

Why does Oxfam think developing countries should get a say in the new tax rules?

Developing countries are part of the growing digital economy. For example, by mid-2016, 73 percent of the world's internet users were from Africa, Asia, the Middle East, Latin America and the Caribbean. At the same time, developing countries depend more on tax revenues from businesses than rich countries, meaning the digitalization of the economy has a greater impact on them. Developing countries urgently need a fundamental reform of the international tax system so they can invest in essential services like hospitals and schools, and lift themselves out of poverty.

What should a global solution look like?

Tax rules should be changed so they can govern a radically changing digitalized economy. Attempts to fit the digital economy into existing tax rules are not sufficient. The tax challenges of the digitalized economy are global, and need global solutions. Developing countries and emerging economies must be at the table when those new rules are discussed – we need to stop letting a small group of rich countries take decisions that affect the entire world. The United Nations is the ideal institution to lead this important initiative, in coordination with the Organisation for Economic Cooperation and Development (OECD) which has led global tax reforms to date.

Contact information

Oxfam's tax experts are available for interviews and background.

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