

Editorial

Should the Taxation of the Digital Economy Really Be Different?

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1 AMPLE INTEREST FOR TAXATION OF THE DIGITAL ECONOMY

The interest in the taxation of the digital economy is increasing on a national, a European and a global level. One of the questions raised is whether the current system of profit taxation is still appropriate for digital business models.¹ The OECD has made the tax challenges of the digital economy the number one of its Base Erosion and Profit Shifting (BEPS) project.² However, concrete proposals are still awaited. They are expected in April 2018. A number of countries has also taken position. For example, the Netherlands has stated that, if action is required, measures should be taken at a global level. After all, the digital economy is a global issue.³ The European Commission believes that this takes all too long.⁴ In its communication of 21 September 2017, it presented a number of options for what it believes to constitute a fair and efficient tax system in the European Union for the digital single market. If at a global level insufficient progress will be made, the Commission will come up with own proposals. Inter alia because of this communication, on 5 December 2017, the Agree with Eric ECOFIN Council highlighted the urgency of agreeing on a policy response at international level. As concerns action at

EU level, the Council called on the Commission to assess thoroughly all options mentioned in the Council's conclusions.⁵

2 OPTIONS OF THE EUROPEAN COMMISSION FOR A FAIR AND EFFICIENT TAX SYSTEM IN THE EU

The Commission makes a distinction between long-term and short-term measures.⁶ In the long run, new international rules specific to the digital economy are needed to determine where the value of businesses is created and how the added value should be attributed for tax purposes. This would entail adjustments of the international tax rules on permanent establishment, transfer pricing and profit attribution applicable to digital technologies. The Commission also believes that the directive proposal on the Common Consolidated Corporate Tax Base (CCCTB) offers a basis to address key challenges of the digital economy.

In the short run, the Commission strongly believes that the lack of taxation of digital businesses, as assumed by the Commission, can be fixed by:

- An equalization tax on turnover of digitalized companies;
- A withholding tax on digital transactions; or
- A levy on revenues generated from the provision of digital services or advertising activity.

The Commission does not care much which of the options will be chosen, if only something will be done. Not really a principle-based policy!

3 WHERE IS THE VALUE ADDED IN THE DIGITAL ECONOMY?

The Commission questions whether the current definition of value creation can still be applied to the digital

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¹ See also e.g. Yariv Brauner & Pasquale Pistone, *Adapting Current International Taxation to New Business Models: Two Proposals for the European Union*, 71(12) Bull. Int'l Tax'n (2017); Georg Kofler, Gunter Mayr & Christoph Schlager, *Taxation of the Digital Economy: 'Quick Fixes' or Long-Term Solution?*, 57(12) Eur. Tax'n (2017); and Wolfgang Schön, *Ten Questions About Why and How to Tax the Digitalized Economy*, Max Planck Institute for Tax Law and Public Finance, Working Paper 2017 – 11 (Dec. 2017).

² See OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (Paris: OECD Publishing 2015).

³ See Letter of Dutch Ministry of Foreign Affairs to the Second Chamber of the Dutch Parliament of 3 Nov. 2017, no. BZDOC-1108098162-129, *Provision of Information on Proposals of the European Commission*.

⁴ See European Commission, *A Fair and Efficient Tax System in the European Union for the Digital Single Market*, 21 Sept. 2017, COM (2017)547 final.

⁵ See ECOFIN Council, *Outcome of the Council Meeting*, 5 Dec. 2017, no. st15305/17, adopting the Council conclusions on 'Responding to the challenges of taxation of profits of the digital economy' of 30 Nov. 2017, no. 15175/17, FISC 320, ECOFIN 1064.

⁶ See European Commission, *supra* n. 4, at 8–10.

economy, because, according to the Commission, in the digital economy, it is less evident where the value is created. The current international tax rules were made when physical presence of businesses was much more important and when digitalization did not yet exist. The Commission believes that these rules are not appropriate anymore, because businesses depend increasingly on intellectual property that can easily be moved, on data and on automation which make large-scale cross-border trade possible with no physical presence.⁷

However, is the digital part of the economy really so much different from the rest of the economy if it concerns establishing where the added value (which includes both profit and loss) is created? I do not think so. In my opinion, added value is ultimately created in all cases by the intellectual element of a human being.⁸ It concerns the labour of the individual, for example as an entrepreneur or an employee. The individual creates the added value mostly with tools, because the work can be done more efficiently and a higher yield can be realized. For example, a carpenter uses a hammer, because it is more efficient to drive a nail into a wall with a hammer than with bare hands. Also less painful! In the digital economy, it is more efficient to process large volumes of data with the help of algorithms than manually. In both cases, the principle is not different. Things themselves do not produce added value, but added value is only created by the intellectual use of the tools by the individual. Raw data do not create added value. This is only done if they are analysed by means of algorithms. To achieve this, the intellectual element of a human being is necessary, for example of programmer who has written the algorithms. So, the place where the added value originates is the place where the individual adds the intellectual element. Therefore, not only in respect of the digital part of the economy, but also for the rest of the economy, what really matters, is: *www*. This means, if the question is answered: ‘who does what where?’, the place where the added value of a production activity is created, is also established. Subsequently, a value must be attributed to that activity.⁹ In this context, it must be noted that in the transfer pricing practice it is or has become common practice on the basis of the arm’s length principle to align with what is known as the people functions.¹⁰ That is also exactly the criterion to establish the place where the value is added for profit tax purposes. In this way, a coherent system of profit taxes is developed.

⁷ See *ibid.*, at 2.

⁸ See also more elaborately, Eric C. C. M. Kemmeren, *Principle of Origin in Tax Conventions, A Rethinking of Models* 21–45, 177–181 (Dissertation PhD thesis Tilburg University, Eric C. C. M. Kemmeren & Pijnenburg vormgevers•uitgevers, The Netherlands: Dongen 2001) (also available on http://webwijs.uvt.nl/publications/304239_ext.pdf), at 37–40.

⁹ See also more elaborately, *ibid.*, at 337–340 and 366–372.

¹⁰ See e.g. OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* 2017 142, 409 (Paris: OECD Publishing 2017).

4 A CHANGE IS NECESSARY, BUT DIFFERENT FROM THE SUGGESTIONS MADE BY THE EUROPEAN COMMISSION

The Commission’s proposals for the short run have not been based on this system. They link up with turnover. In essence, this is also true in respect of a withholding tax on digital transactions. Such a tax is actually a use tax. However, we have already included turnover and use taxes in our tax system, for example VAT and sales and use taxes. Therefore, it is more than questionable of whether countries providing a sales market will be sidelined in the process if they cannot tax profits of digital enterprises because these enterprises have no physical presence in these countries. Such enterprises are doing business *with* these countries, but not *in* these countries. As producers of goods and services, they do not directly benefit from the public expenses of these countries; the consumer or the user does. The consumer or user uses the infrastructure of these countries to consume respectively use the digital goods and services. If these countries believe, nevertheless, that they have a legitimate claim to tax profits of producers of digital goods and services, because of the fact that a producer cannot earn any income without a sales market, the reverse is also true. A buyer cannot consume or uses goods or services without them being produced on a production market. Consequently, the countries providing a production market could also legitimately claim a part of the VAT or sales and use taxes. This would not only be true in respect of digital goods and services, but also in respect of physical goods and services. As a result, international tax systems would be made needlessly complicated. I believe that is also not necessary, because the current distribution of taxing rights has already been based on the distinction between the production of added value (income and profit taxes) and the consumption or use of added value (VAT and sales and use tax).

Nonetheless, I also believe that profit taxes must be adjusted. Indeed, the current term permanent establishment is out of date.¹¹ The current economies have developed much more in service economies. As a consequence, the relevance of physical constructions has decreased. Furthermore, as has been emphasized above, tools, things, physical constructions themselves do not create added value, but the added value is created by the intellectual element of a human being. This means that the concept of permanent establishment should be replaced by the concept of substantial income producing entrepreneurial activities carried out by a human being. This concept can be filled in more concretely by, for example, the number of days that an individual works in a country. Consequently, it is not necessary to distinguish between activities of natural persons working in the digital part of the economy and the rest of the economy.

¹¹ See also more elaborately, Kemmeren, *supra* n. 8, at 323–332 and 355–366.