

INTERNATIONAL TAXATION OF DIGITAL SERVICES – NECESSITY OR ABUSE?

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Abstract

In the 20th century, most developed countries taxed and redistributed - either in money or in kind - part of their wealth. This was done by taxing economic activities, either on the production side or on the consumer side. The wave of globalization that emerged after World War II and, more importantly, since the early 1990s, has made it difficult in some countries to tax companies, as tax evasion or tax optimization have become easier. Even in the case of these cross-border activities, as long as most of the sold items came from the traditional brick companies, this was more of an implementation problem than of design. The development of the digital economy on the basis of increasing returns on scale and intangible assets is a more fundamental problem. The purpose of this paper is to analyse the pros and cons of applying the taxation of digital services and goods on economic transactions with these types of services or goods.

Key words: taxation; digital service; control.

JEL Classification: M41

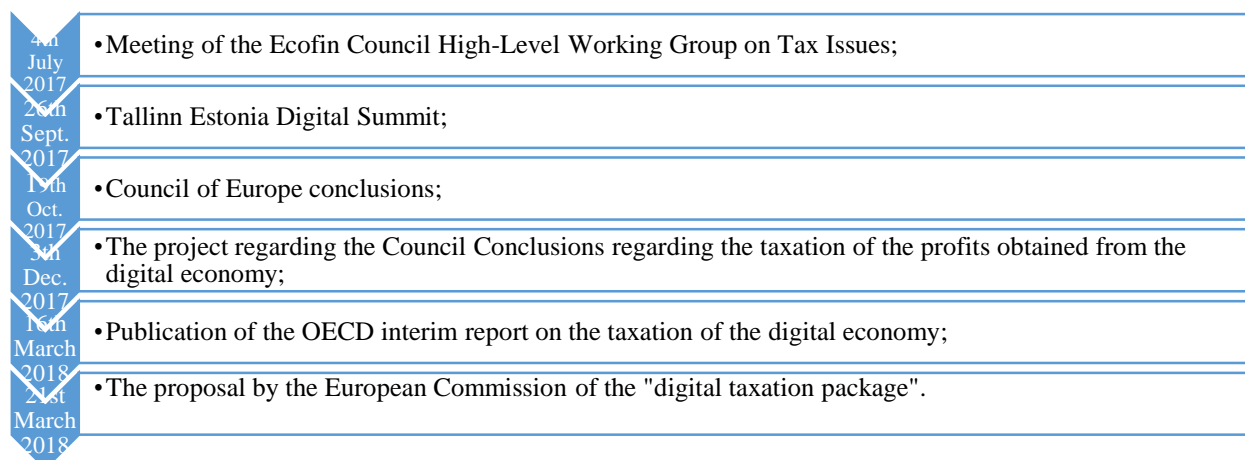
I. INTRODUCTION

Aspects regarding the control of digital services at European Union level - direct taxation

The challenge related to the taxation of profits obtained by companies providing digital services is one of the most sensitive issues regarding fiscal harmonization from 2019 to 2020. This is because the tax regulations are generally drafted for traditional economic entities and are based on the principle of taxing the profit where value is created. But digital economic entities create more value from the online environment without having a physical presence in the Member State where they make their income. This has the effect of not taxing or taxing in another state the profit obtained.

The tendency at the OECD level and at the level of the European Union is to create a harmonized fiscal framework to ensure the taxation of profit in the state in which the economic activity that generated it is performed, respectively in the state where the plus value was created. However due to an insufficient regulatory framework at European Union level in this area, starting from 2017 the European Union has begun to take numerous actions to create and develop an effective tax system that is fair, suitable for the digital age, as follows:

Figure 1 - The steps taken by the European Union regarding the elaboration and implementation of legislative regulations regarding the direct taxation of digital services



Source: processed after CECCAR, *Challenges of the development of the digital age regarding tax systems. Taxation of the deficit economy*, Expertise Magazine and Business Audit, no. 47 (2019), available

online at <http://www.ceccarbusinessmagazine.ro/provocari-ale-devoptarii-erei-digitale-regarding-fiscal-systems-taxarea-economie-digitale-a5684/>, accessed on January 09 2020

The conclusions of these actions are summarized in the package of measures proposed on March 21th, 2018, namely the 3% taxation of revenues from digital services and, as a long-term solution, the definition of the concept of "permanent digital headquarters". The new 3% tax on gross revenues obtained from digital services aims to eliminate the possible differences that may arise at EU level as a result of the implementation of the unilateral initiatives of the Member States.

The unique fee should be due in the Member State where the users are located. If they are located in different Member States the tax base should be distributed in the respective Member States based on an allocation key. The tax on digital services will be applied by the economic entities that fulfill (individually or at group level as the case) the following conditions¹:

- Total annual global revenues exceeding 750 million euros;
- Annual revenue from the provision of digital services in the European Union of at least 50 million euros.

The exchange rate used in the situation of obtaining income in a currency other than the euro is the one communicated in the Official Journal of the European Union at the last date of the relevant financial year. The taxable incomes proposed by the proposal for a Council Directive consists of:

- "placing on a digital interface of advertising materials targeted at the users of the respective interface;
- Providing users with a multilateral digital interface that allows users to find and interact with other users and which could also facilitate the underlying provision of goods or services directly between users;
- transmission of data collected on users, generated by the activities of users on digital interfaces"².

Many dimensions of the digital economy are difficult to evaluate. Part of the business is based on free goods; which are apparently free services for consumers but are actually provided in exchange for information about consumer characteristics. (Mates, Hlaciuc, & Socoliuc, 2009; Cosmulese, Grosu, & Hlaciuc, 2017; Cosmulese, Grosu, & Hlaciuc, 2017; Cosmulese, Grosu, Hlaciuc, & Zhavoronok, 2019).

Keep in mind that simply defining an economic transaction is difficult, as there is no price paid for consumer services, it is unclear when and how economic transactions should be characterised (Mateş, D., Socoliuc, M., Hlaciuc, E., Haiduc, C., & Ursu, 2010; Grosu, Socoliuc, & Hlaciuc, 2017; Ciubotariu, Socoliuc, Mihaila, & Savchuk, 2019). Not included in the scope of taxable income are the services regarding digital content or payment services, respectively the trading places of financial instruments and the platforms for facilitating investment services, as regulated by Directive 2014/65/ EU of the European Parliament and of the Council of 15 May 2014 on the markets for financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU published in the Official Journal of the European Union L 173/349/12.06.2014. The first country to transpose the national taxation of digital services with a rate of 3% is France which in 2019, adopts in August 2019, the law on the GAFA (from the big digital service providers Google, Apple, Facebook and Amazon). The GAFA tax also applies retroactively to businesses in 2019.

Starting with January 1, 2020, Italy is implementing this tax at a level of 3% applied to taxable income obtained from digital services. Austria is implementing, at the same time, the taxation of digital services, but the quota is 5% applied to the turnover realized from the provision of digital services. Greece, Hungary, Slovakia are other Member States that have found a way to implement the GAFA tax in their national laws, individually, without waiting for the implementation of the single quota at EU level. The effects of digital services taxation

The development of the digital economy on the basis of increasing returns on scale and intangible assets is a more fundamental problem. Not only is it difficult to tax digital goods, but it is also difficult to define what should be taxed. As a result, digital business models are subject to an effective tax rate of only 9%, which is less than half that of traditional business models (see European Commission, 2018). (OECD/G20, 2018)

Morgan (2016) investigated the roots of international taxation issues, arguing that profits should be reported as to where they are created. Currently, MNC are making profits from many places around the world, which may confuse the origin of profits. The current law cannot keep up with the current business environment because it leads to abuse. Morgan says. Arel-Bundock (2017) indicated that international tax treaties between countries give rise to treaty purchases. Here begins the problem of tax gaps. Arel-Bundock argues: "*The international tax system is a complex regime composed of thousands of bilateral tax treaties. These agreements coordinate policies between countries to avoid double taxation and to encourage international investment...*" This implies that multilateral tax treaties determine double taxation. To mitigate the inappropriate effect, the solution is several treaties. As a result, it provides the MNC with a treaty shopping opportunity.

¹ Article 4, paragraph 1, proposal for a Council Directive on a common system of taxation of digital services for the revenues resulting from the provision of certain digital services, 2018/0073, Brussels

² Article 3, paragraph 1, proposal for a Council Directive on a common system of taxation of digital services for the revenues resulting from the provision of certain digital services, 2018/0073, Brussels

Olbert and Spengel (2017) have shown that current international legislation has been out of step with what is being done in practice and, in fact, it is not at the same speed as technological progress. They state: *"The phenomenon of digitalization is considered the most important evolution of the economy since the industrial revolution and one of the main engines of growth and innovation. At the same time, the digital economy is associated with major challenges for the international tax system. Traditional tax laws regulate new modalities of business development, but the current international tax law and its fundamental principles may not have kept pace with the changes in the global business practices."*

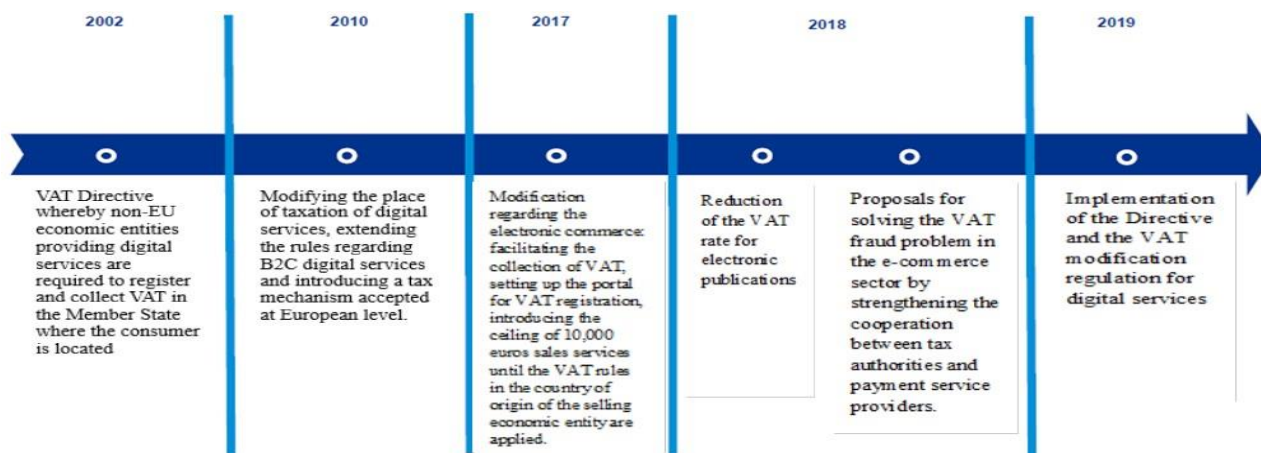
Price transfer is probably the most serious problem in the field of international taxation. Riley (2014) (Hlaciuc, Grosu, Socoliuc, & Maciuc, 2014) emphasized that: *There is a general maxim that taxpayers want to minimize their tax liability to the greatest extent possible. However, taxpayers who pursue this goal excessively risk crossing the line that separates the allowed tax evasion and the unacceptable tax evasion. In the field of international business tax law, nowhere is this problem more pressing than in the arena of transfer pricing, in cases where the taxpayer is a multinational enterprise (MNE) composed of corporate entities located in several tax jurisdictions around the world.*

This means that multinational companies are increasingly abusing "transfer pricing" between the parent company and its foreign corporation controlled as a vehicle to transfer its profits from one higher tax rate country to a lower tax rate country. The only purpose is to minimize their overall fiscal obligations (Hlaciuc, Grosu, Socoliuc, & Maciuc, 2014; Grosu, 2009; Grosu, Hlaciuc, Iancu, Petris, & Socoliuc, 2010; Grosu & Lupu, 2016).

Aspects regarding the control of digital services at EU level - indirect taxation

The evolution of the European Union's concerns regarding the indirect taxation of digital services is reflected in the figure no. 2, as follows:

Figure 2 - The steps taken by the European Union regarding the elaboration and implementation of legislative regulations regarding the indirect taxation of digital services



Source: processed by KPMG, *Taxation of the digitalized economy*, 2019, p. 23, available online at <https://tax.kpmg.us/content/dam/tax/en/pdfs/2019/digitalized-economy-taxation-developments-summary.pdf>, accessed on January 09, 2020

The main regulations regarding the indirect taxation of digital services to be transposed into national law are: Council Directive 2017 on the amendment of Directive 2006/112/EC and Directive 2009/132/EC on the obligations regarding TVA related to digital services and other VAT regulations regarding digital services such as the 2017 Regulation on measures for the implementation of the common VAT system, respectively the 2017 Regulation on administrative cooperation and combating VAT fraud, the latter has been in effect since 1 January 2021.

In the case of an economic entity a Romanian legal entity that provides digital services provided to a non-taxable person in the European Union for example the place of the provision is considered, by way of

exception, to be the Member State in which the consumer is³. In this situation the economic entity either registers for VAT purposes in each Member State where the beneficiary for which it provides digital services and submits tax declarations in the respective Member State or registers in the Mini One Stop Shop (M1SS) application and submits tax declarations through the application. In this situation the VAT payment will be made in a special account from which the amount will be transferred to the respective Member States. The condition of registration in M1SS is that the economic entities providing / providing digital services are registered as VAT payers.

The exception provisions of the Fiscal Code regulated by art. 278 paragraph (5) letter (h) are harmonized with the provisions of the EEC Directive no. 8/2008 amending the EEC Directive no. 112/2006 regarding value added tax.

II. INTERNATIONAL TAXATION OF DIGITAL SERVICES – NECESSITY OR ABUSE?

Although the factors that can create hyper-growth in digital markets (network effects and massless scale) can bring considerable benefits to the well-being of consumers in the form of new accessible and innovative services, the same factors can also stifle competition by strengthening market positions of the strong companies that they helped to grow. Specifically, a company on the market that benefits from network and mass-scale effects can sometimes become so powerful that it can leave those who want to enter in the near future to face an obstacle in the path for their growth. The path of new entrants is more difficult because, unlike the first companies entered in the field, they try to enter a market that already has a large and growing number of users who benefit from economies of scale and network effects.

Moreover, some operators in digital markets benefit from high transfer costs, which can block customers (captive customers) and make it more difficult for them to enter the market. The more consumers use online services, the more they get used to and are reluctant to leaving/transferring from them. In addition, the more consumers provide more data to the service, the harder or more expensive the transfer of these data to a competitive service is and the less likely the customer is to pass, even if prices increase, as the quality or service offers less privacy. And when their data is not just about a particular type of service, but an entire ecosystem, whose individual service is only one part, consumers are even less willing to move to a new provider. This can happen, for example, with regard to cloud service providers. Thus, network effects, massless scale and blocking effects can be combined to reduce competition in digital markets. However, if a participant has a substantially superior product or service, the benefits of network and massless scale can move from the old operator to the new operator and can cover any blocking effect that has previously protected the market leader. When this happens, the current leader can be demoted even faster than the time required for their ascension. The move from Yahoo to Google in Internet search and the MySpace overthrow by Facebook are two examples of this phenomenon.

Thus, although the hyper growth allowed by digitization in some markets may lead to less competition, it is sometimes the case for digital companies to acquire and lose market power faster than in traditional, growing markets. That is, digital markets can see a succession of powerful companies that periodically destroy their predecessors. This is not a competition in the classical static sense, with a large number of rivals simultaneously fighting against each other mainly on the basis of price. Instead, it is a competition based on innovation, which takes place over time.

As digitization continues to affect competition, it may lead to some adjustments to competition policy as well. One possible change is that, as digitization shifts production from atoms to bits, the focus of competition policy may extend beyond goods, services, and revenues to also include data. That is, it might recognize that the growth of digital businesses that provide "free" services in exchange for customer data, for example, implies that data is the key resource in certain markets of the digital economy. Therefore, the data could be considered to be the main active element in certain aspects related to the application of competition, whether they involve fusion control, unilateral or coordinated behaviour. Finally, digitization raises the forces of international cooperation and coordination in competition policy. Due to the connectivity and bandwidth, more and of more companies are "born globally". Therefore, business practices in the digital economy have a greater tendency to produce effects in different jurisdictions. This creates a risk of jurisdictional litigation, different legal standards applied simultaneously to the same practice, inconsistency in the application of competition law, arbitration or "forum shopping" by the companies that seek the most indulgent environment for their business practices and a decrease in the efficiency of the ways attack.

³ Article 278, paragraph 5, letter h, Law no. 227/regarding the Fiscal Code, published in the Official Gazette no. 688 of September 10, 2015, as amended and supplemented

III. CONCLUSION

The current processes of digitization of economies lead to the new fiscal challenges as a result of the emergence of new business models, which do not need the physical presence to carry out various transactions. These challenges are generally related to the erosion of the tax base and the transfer of profits by companies operating in different jurisdictions, due to the different taxation regimes of corporate income.

Developed countries around the world have developed appropriate guidelines - the BEPS project, aimed at addressing corporate tax avoidance strategies, including digital ones, that operate under tax rules to transfer profits to lower or rated jurisdictions.

The new tax model proposed by the EU, the 3% share of the revenues from the digital activities correlated with the other two conditions creates the premises of an unfair competition, in my opinion, as the companies launching in the digital space with digital services will have enough time and skill to search the best solutions to avoid paying a 3% fee. The threshold of 100,000 users and exceeding the number of 3000 contracts for the provision of digital services seems to me very easy to reach, while I consider that the threshold regarding the turnover of 7 million euros requires enough time.

The new digital tax is, however, a new fiscal mechanism to which EU member states have to adjust the new business models. If reported at the level of 2018, the turnover made by Facebook at EU level would be taxed with the 3%, it would bring an additional \$409 million share in the budgets of the Member States, provided that the turnover from the advertisement registered \$13,631 million to an average number of 381 million users.

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