Policy Paper

QUO VADIS? ENSURING FAIR TAXATION IN THE DIGITAL ECONOMY

Silke Maes

July 2023

About the Author

Silke Maes is a European Studies graduate from Ghent University in Belgium. She studied abroad at Sciences Po Toulouse, and is currently doing an Erasmus Mundus masters in European Politics And Society at Charles University in Prague, and Leiden University. Her research interests are centred around European social policy and the external aspect of European migration management.

About EUROPEUM

EUROPEUM Institute for European Policy is a non-profit, non-partisan, and independent think-tank focusing on European integration and cohesion. EUROPEUM contributes to democracy, security, stability, freedom, and solidarity across Europe as well as to active engagement of the Czech Republic in the European Union. EUROPEUM undertakes original research, organizes public events and educational activities, and formulates new ideas and recommendations to improve European and Czech policy making.

EUROPEUM
INSTITUT PRO EVROPSKOU POLITIKU
INSTITUTE FOR EUROPEAN POLICY

Co-funded by
the European Union

Table of contents

Executive summary

The increasing digitalisation of the economy poses fundamental challenges to tax systems. The growing reliance on intangible assets, which are easy to move but hard to value, exacerbates old problems of tax avoidance and competition while also creating new problems as certain activities completely escape taxation. Recently, the emergence of highly profitable digital business models, combined with the covid crisis – which put a financial strain on governments – has **led to a renewed interest in fair taxation.** As a result, several measures are currently being discussed at the OECD, EU and national levels to ensure that companies pay taxes in the jurisdictions where they generate profits.

OECD: In October 2021, 136 OECD countries struck a deal to halt corporate tax evasion and make the international tax system fit for the digital age by introducing a global minimum corporate tax base of 15% and shifting taxing rights to where profits are made. If implemented, the agreement could be the most fundamental international tax reform in a century and introduce market-country taxation as the new dominant paradigm.

- **Advantages**: There is a broad consensus that an international agreement would most effectively address the current problems and limit loopholes for aggressive tax planning. In addition, the Inclusive Framework can open the door for a more harmonised EU approach to taxation.
- **Limitations**: On the other hand, it is uncertain as to whether the agreement will actually be implemented. As progress is stalling (notably on pillar one), the Commission is under increasing pressure to propose an EU solution.

EU: The EU is particularly vulnerable to aggressive tax planning and tax competition. A focus on negative integration, with only partial re-regulation at the EU level, has encouraged tax competition and aggressive tax planning, negatively affecting the EU's overall tax revenues and harming local businesses. Over the past ten years, the Commission has launched several initiatives to ensure fair taxation in the digital age, none of which have been implemented due to a lack of unanimity and external constraints (especially from the US).

- **Plan A: BEFIT:** In the ideal scenario, the EU can use the deal reached at the OECD level to forge further tax integration within the Union. It could build on the Inclusive Framework to introduce BEFIT, which would establish a common tax base and a formula for allocating profits between member states.
- **PLAN B: EU Digital levy**: In addition, it is possible to see a revival of the DST, either instead or in addition to other OECD and EU measures. A digital levy requires a less comprehensive reform of the EU tax rules and might be easier to implement. On the other hand, It might lead to international tensions, and the administrative costs outweigh the revenues in some member states.

National levies: If neither the OECD nor the EU can reach an agreement on digital taxation in the near future, it is likely to see a further proliferation of initiatives at the national level.

- **Advantages:** On the one hand, unilateral levies can respond to the need for immediate action and serve as 'a whip' to speed up international initiatives.
- **Limitations:** On the other hand, unilateral action will likely spark tension over trade, undermine the level playing field, and might not generate as much additional revenue as hoped. Whether the game is worth the candle

depends on the national context, but unilateral DSTs should always be regarded as a third-best option.

Recommendations:

1. **A ‘global’ solution**: Tax challenges related to the digitalisation of the economy are global in scope. Even a European solution would still be of a local nature, allowing loopholes to persist while potentially negatively impacting businesses. Therefore, it is crucial that the political agreement reached by the OECD countries is actually implemented.

2. **A need for further EU tax integration**: The EU member states must strive for the EU-level implementation of the Inclusive Framework, which will increase uniformity and facilitate much-needed further EU integration in the field of taxation. In addition, the EU must strive for a common consolidated corporate tax base, which is the best way to provide a just tax system while contributing to the Digital Single Market.

3. **Decision making**: QMV for tax matters: In the longer term, the EU needs to introduce QMV for tax matters so that it can tackle tax-related problems that are -due to the existence of the internal market- inextricably linked to the EU level. While awaiting institutional change, the EU should dare to consider enhanced cooperation as a second-best option.

Conclusion: The situation in digital taxation is evolving rapidly. A window of opportunity has opened that has the potential to change the current consensus on taxation. However, it remains to be seen which, if any, international initiative will be successfully implemented. If both the OECD and EU fail to find an agreement, it is likely to see the further spread of unilateral taxes on digital services.

Quo Vadis? Ensuring fair taxation in the digital economy

Introduction: changing the rules? A window of opportunity for reform

Tax policy plays a crucial role in the distribution and redistribution of resources. It is a primordial precondition for social spending and guarantees a fair and competitive digital market[1]. In recent years, there has been increasing criticism that the current tax rules – based on companies' physical presence in the economy – no longer fit the modern context. Indeed, digitalisation poses a fundamental challenge to the 100 years old[2] international tax system, as companies increasingly rely on intangible assets, which are easy to move but hard to value[3]**. The emergence of highly digitalised business models, combined with the covid crisis – that left governments searching for extra revenues[4] - has led to a renewed interest in fair taxation**. As a result, several measures are currently being taken to ensure that companies pay taxes in the jurisdictions where they generate profits.

If implemented, the Inclusive Framework could become the most fundamental reform of the international tax system in a century.

The most significant initiative is the recent **OECD agreement** (Inclusive Framework). In October 2021, 136 countries agreed to a reform of the

[1]European Commission. 2021. Fair Taxation: Commission launches a public consultation on the digital levy. Available at: https://digital-strategy.ec.europa.eu/en/consultations/fair-taxation-commission-launches-public-consultation-digital-levy.
[2] Gelepithisa and Martin Hearson. 2022. The politics of taxing multinational firms in a digital age https://www.tandfonline.com/doi/epdf/10.1080/13501763.2021.1992488?needAccess=true&role=button.
[3]Durán-Cabré. 2021. The Impact of Digitalisation on Tax Systems. Available at: https://ieb.ub.edu/wp-content/uploads/2022/02/INF-IEB-FFFP-2021.pdf#page=38.
[4]Kendrick. 2021. The EU Transatlantic agenda on 'fair' corporate taxation: Is a digital services tax a workable 'Plan B'?. available at: https://openaccess.city.ac.uk/id/eprint/27786/1/Maria%20Kendrick%20EU%20LAW%20LIVE-%20Digital%20Services%20Tax%20-%20AAM%20.pdf.

international tax system, which aims to tackle tax base erosion and make the international tax system fit for the digital age[5]. If implemented, the agreement could become the most fundamental reform of the international tax system in a century[6]. Meanwhile, other initiatives are being discussed at the EU and national levels.

The proliferation of tax initiatives at various levels and the possible emergence of a new international tax consensus[7] make it the perfect moment to look at the challenges and opportunities brought by digital taxation and the initiatives to regulate the phenomenon. Multiple questions arise: **What options for fair digital taxation are currently being discussed at the OECD, EU and the National level? What are their advantages and limitations, and what can be expected of the future?**

Digitalisation, intangible assets, and a need for legislative action

Highly digitalised companies heavily rely on intangible assets, which are easy to move and hard to value[8]. **On the one hand, the upcoming new digital business models exacerbate the existing problems of profit shifting, tax avoidance and tax competition**, as companies can increasingly create value without being physically present. For example, tech giants (such as Facebook and Google) generate significant value from advertising. While these revenues have greatly

[5] Allenbach-Ammann and Noyan. 2021. 136 countries agree on international tax reform. Available at: https://www.euractiv.com/section/economic-governance/news/136-countries-agree-on-international-tax-reform/.
[6] Durán-Cabré. 2021. The Impact of Digitalisation on Tax Systems. Available at: https://ieb.ub.edu/wp-content/uploads/2022/02/INF-IEB-FFFP-2021.pdf#page=38.
[7] Namely, taxation based on market presence.
[8] Durán-Cabré. 2021. The Impact of Digitalisation on Tax Systems. Available at: https://ieb.ub.edu/wp-content/uploads/2022/02/INF-IEB-FFFP-2021.pdf#page=38.

increased over time, they are predominantly reported in low-tax countries[9]. In addition, the increased mobility of assets makes digital companies even more sensitive to tax competition, putting further pressure on corporate tax rates that have decreased over the past 40 years[10]. **On the other hand, digitalisation also created new problems** as several new activities, such as online advertising and user-generated data, completely escape taxation yet hold high potential for monetisation[11]. While, at the international level, there is awareness of this problem, there is no common understanding of how value creation should be defined[12].

Highly digitalised multinationals took advantage of the opportunity provided by the outdated tax system to shift profit to low-tax countries[13]. Today, the lowest taxes "are systematically paid by the most valuable and highly digitalised MNEs"[14] such as Amazon, Google and Facebook, leading to the concentration of wealth in the hands of a few companies and the people who own them[15]. The mismatch between an outdated tax system based on physical presence and the way new digital businesses generate revenue has **consequences for the sustainability of governments' finances.** It is estimated that the EU suffers from a net loss in revenues of €36.0 billion[16]. While it is difficult to assess the exact impact of tax

---

[9] Koethenbuerger. 2020. Taxation of Digital Platforms. Avaiable at : https://www.econstor.eu/bitstream/10419/219503/1/econpol-wp-41.pdf .

[10] The nominal corporate tax rate in the OECD has fallen from 50% in 1980 to 22.85 percent in 2021. Meanwhile the burden of taxation has shifted to labour.

[11] European Council. 2022. Digital taxation. Available at: https://www.consilium.europa.eu/en/policies/digital-taxation/.

[12] Szczepański. 2018. Interim digital services tax on revenues from certain digital services. Available at: https://www.europarl.europa.eu/RegData/etudes/BRIE/2018/625132/EPRS_BRI(2018)625132_EN.pdf.

[13] Durán-Cabré. 2021. The Impact of Digitalisation on Tax Systems. Available at: https://ieb.ub.edu/wp-content/uploads/2022/02/INF-IEB-FFFP-2021.pdf#page=38.

[14] Multinational enterprises

[15] Gelepithisa and Martin Hearson. 2022. The politics of taxing multinational firms in a digital age https://www.tandfonline.com/doi/epdf/10.1080/13501763.2021.1992488?needAccess=true&role=button.

[16] Álvarez-Martínez, Barrios, d'Andria, Gesualdo, Nicodeme and Pycroft. 2022. How large is the corporate tax base erosion and profit shifting? A general equilibrium approach. Available at: https://www.tandfonline.com/doi/full/10.1080/09535314.2020.1865882.

optimisation on the Czech Republic, a 2016 expert survey estimated the loss of revenue at around 20 billion CZK (or €0.7 billion) [17].

OECD: action at international level

The problems described above are of a global nature. A multilateral approach is, therefore, to be preferred[18]. While the interests between states differ greatly, there exists a common interest in having one single set of rules[19]. The recent spread of unilateral digital taxes has spurred negotiations at the international level[20]. In October 2021, 136 OECD countries struck a deal with the aim to put corporate tax evasion to a halt and make the international tax regime fit for the digital age[21]. If implemented, the current agreement could be the most fundamental international tax reform in a century and introduce market-country taxation as the new dominant paradigm[22]. In addition, the European Commission plans to use the OECD deal "as a stepping stone to more unified rules for business taxation across the EU"[23].

---

[17] Janský. 2018. Estimating the revenue losses of international corporate tax avoidance: the case of the Czech Republic. Available at: https://www.tandfonline.com/doi/full/10.1080/14631377.2018.1443243.

[18] Council of the European Union. 2019. Proposal for a Council Directive on the common system of a digital advertising tax on revenues resulting from the provision of digital advertising services – Political agreement. Available at : https://data.consilium.europa.eu/doc/document/ST-6873-2019-INIT/en/pdf.

[19] OECD. 2018. Tax Challenges Arising from Digitalisation – Interim Report 2018. Available at : https://www.oecd-ilibrary.org/docserver/9789264293083-en.pdf?expires=1676368473&id=id&accname=guest&checksum=5C7B113BFFE094CF26961C76D9CE29ED.

[20] Vázquez. 2023. Digital Services Taxes in the European Union: What Can We Expect?. Available at: HTTPS://KLUWERTAXBLOG.COM/2023/02/14/DIGITAL-SERVICES-TAXES-IN-THE-EUROPEAN-UNION-WHAT-CAN-WE-EXPECT/.

[21] Allenbach-Ammann and Noyan. 2021. 136 countries agree on international tax reform. Available at: https://www.euractiv.com/section/economic-governance/news/136-countries-agree-on-international-tax-reform/ .

[22] Durán-Cabré. 2021. The Impact of Digitalisation on Tax Systems. Available at: https://ieb.ub.edu/wp-content/uploads/2022/02/INF-IEB-FFFP-2021.pdf#page=38.

[23] Euractiv. 2021. EU proposes unified corporate tax regime fit for 21st century. Available at : https://www.euractiv.com/section/economy-jobs/news/eu-proposes-unified-corporate-tax-regime-fit-for-21st-century/.

A two-pillar aproach

The agreement is based on a two-pillar approach. **The first pillar shifts, for the first time, taxing rights from the jurisdiction where goods and services are produced to the jurisdiction where consumers are located**[24]. More concretely, 25 per cent of the companies' profits above a 10 % profit margin would be reallocated from the country of establishment to the market country[25] . This means that a small portion of profits from highly profitable businesses (like Apple or Google) will be allocated to the Czech Republic or France and no longer solely to their country of establishment[26]. With the current criteria, pillar one would affect around the 100 largest companies, both digital and non-digital, that have a global turnover above $20 billion and profitability over 10%[27]. Under pressure from the US, the initial proposal was watered down. The agreement no longer specifically targets tech giants. In addition, due to the 10% threshold, companies such as Amazon will be excluded from the regime[28]. Nevertheless, the OECD estimates that the provisions as set out in the pillar will generate 108 billion euros in additional taxes[29].

The second pillar introduces a minimum corporate tax base of 15%, which aims to discourage companies from shifting profits to tax havens and counter tax base erosion[30]. The pillar applies to companies with a turnover of

[24] Durán-Cabré. 2021. The Impact of Digitalisation on Tax Systems. Available at: https://ieb.ub.edu/wp-content/uploads/2022/02/INF-IEB-FFFP-2021.pdf#page=38.

[25] Baert. 2022. Corporate taxation reform: What comes next?. Available at : https://www.europarl.europa.eu/RegData/etudes/ATAG/2022/733699/EPRS_ATA(2022)733699_EN.pdf.

[26] Allenbach-Ammann. 2021. National digital taxes and US sanctions to be withdrawn after OECD tax deal. Available at: https://www.euractiv.com/section/economy-jobs/news/national-digital-taxes-and-us-sanctions-to-be-withdrawn-after-oecd-tax-deal/.

[27]Allenbach-Ammann and Noyan. 2021. 136 countries agree on international tax reform. Available at: https://www.euractiv.com/section/economic-governance/news/136-countries-agree-on-international-tax-reform/.

[28]*Ibid.*

[29]*Ibid.*

[30]*Ibid.*

over €750 million[31] and works as follows. If a company shifts profits to a tax haven where the tax base is lower than 15% (e.g. 10%), the country of establishment has the right to tax the difference (5%). With a global minimum corporate tax rate in place, MNEs would have no incentive to uphold a tax rate under 15%[32]. The EU Tax Observatory estimates that the second pillar could generate an additional yearly tax revenue of €48 billion across the EU[33]. However, it remains to be seen how the pillar will work in practice and whether the mechanism will suffice to stop tax competition[34].

Advantages: the merits of an international solution

Both in academics and also at the EU level, there is a broad consensus that international agreement is the most effective way to address the current problem[35]. The introduction of one framework will prevent distortions and would be **most effective at avoiding loopholes for aggressive tax planning**[36]. Even if the outcome of the agreement turns out to be modest, it will most likely be more efficient than a patchwork of efforts to attract or crack down on MNEs who wish to avoid high tax rates[37]. Therefore, even if an international deal requires concessions[38], the OECD momentum is an opportunity that cannot be missed.

An additional advantage of an agreement at the OECD level is that **it can open the door for a more harmonised EU approach to taxation**[39]. Firstly, the approval of

[31] *Ibid.*
[32] *Ibid.*
[33] *Ibid.*
[34] https://ieb.ub.edu/wp-content/uploads/2022/02/INF-IEB-FFFP-2021.pdf#page=38
[35] https://openaccess.city.ac.uk/id/eprint/27786/1/
[36] The Effects of Digital Service ("Google") Taxes on Multinational Digital Platforms https://ieb.ub.edu/wp-content/uploads/2022/02/INF-IEB-FFFP-2021.pdf#page=38
[37] Christie. 2021. International tax debate moves from digital focus to global minimum. Available at: https://www.bruegel.org/blog-post/international-tax-debate-moves-digital-focus-global-minimum.
[38] e.g. Estonia, Hungary and Ireland received carve-outs while Saudi Arabia pleads for exemptions for extractive activities.
[39] Allenbach-Ammann and Noyan. 2021. 136 countries agree on international tax reform. Available at: https://www.euractiv.com/section/economic-governance/news/136-countries-agree-on-international-tax-reform/.

Estonia, Hungary and Ireland to the Inclusive Framework allows for the agreement to be transferred into EU law. In addition, the EU wants to use the OECD agreement as a basis for further EU tax harmonisation[40]. The Commission has already communicated that the implementation of BEFIT – the latest initiative for a common consolidated tax base – will be strongly based on the outcome of the global talks[41].

Limitations: Implementing the Inclusive Framework: a done deal?

While ensuring fair taxation at the OECD level is ideal, working towards an international consensus is a difficult and lengthy process. Discussions have been going on for some time, and even though a political agreement was reached in October 2021, **the question remains as to whether the agreement will be implemented.** While the negotiations on the implementation of pillar two are advancing – having a good chance that it be implemented in the coming months – progress on pillar one is stalling[42]**.**

Not only is the first pillar more technical, but it also rewrites the very principles on which the international tax system was based[43]. According to the French minister for economy and finance, negotiations are currently blocked by India, Saudi Arabia and the US[44]. There is scepticism that pillar one will be agreed upon in 2023 and can enter into force in 2024[45]. Instead, it is more probable that pillar one will

---

[40]Christie. 2021. International tax debate moves from digital focus to global minimum. Available at : https://www.bruegel.org/blog-post/international-tax-debate-moves-digital-focus-global-minimum.
[41] *Ibid.*
[42] Basso. 2023. Chances of taxing digital giants 'slim', says French minister. Available at : https://www.euractiv.com/section/politics/news/chances-of-taxing-digital-giants-slim-says-french-minister/.
[43] Mehboob. 2020. EU may keep DST even after the OECD finalises digital tax plans. Available at : https://www.proquest.com/docview/2467513452?pq-origsite=gscholar&fromopenview=true.
[44] The main points of disagreement concern the scope of exemptions for extractive activities (Saudi Arabia) and the a reinforcement of the tax capacity building mechanism for developing countries (India).
[45] Vázquez. 2023. Digital Services Taxes in the European Union: What Can We Expect?. Available at: HTTPS://KLUWERTAXBLOG.COM/2023/02/14/DIGITAL-SERVICES-TAXES-IN-THE-EUROPEAN-UNION-WHAT-CAN-WE-EXPECT/.

continue to delay and ultimately fail[46]. In the latter case, it will likely lead to a further spread of unilateral digital taxes[47]. Alternatively, an EU-level solution could be sought. In response to the gridlock on pillar one, the French finance and economy minister reiterated that if no agreement on the practical implementation can be reached, **implementation at the European level could be considered**[48]. Indeed, if the negotiations drag on, the Commission will be under increasing pressure to take action[49].

The EU: action at the EU level

Google in Ireland: the European tax system and the cost of partial integration

Within the context of the European Union, action in the field of taxation is even more imperative. The creation of the internal market – with its free movement of capital – combined with fewer technological barriers to trade has led to an increased sensitivity to differences in corporate tax rules between the member states[50]. This has made the EU particularly vulnerable to aggressive tax planning.

Since the creation of the internal market, MNEs function as a single unit in the EU[51]. However, taxation remains, to a large extent, a competence of the member states. This partial integration enables MNEs to redirect their profits to low-tax

[46] *Ibid.*
[47] *Ibid.*
[48] Basso. 2023. Chances of taxing digital giants 'slim', says French minister. Available at : https://www.euractiv.com/section/politics/news/chances-of-taxing-digital-giants-slim-says-french-minister/.
[49] Vázquez. 2023. Digital Services Taxes in the European Union: What Can We Expect?. Available at: HTTPS://KLUWERTAXBLOG.COM/2023/02/14/DIGITAL-SERVICES-TAXES-IN-THE-EUROPEAN-UNION-WHAT-CAN-WE-EXPECT/.
[50] European Commission. 2001. Company taxation in the internal market. Available at : https://taxation-customs.ec.europa.eu/system/files/2016-09/company_tax_study_en.pdf.
[51] Tang and Bussink. 2017. EU Tax Revenue Loss from Google and Facebook. Available at : https://www.actuel-direction-juridique.fr/sites/default/files/eu-tax-revenue-loss-from-google-and-facebook_0.pdf.
European Commission. 2001. Company taxation in the internal market. Available at : https://taxation-customs.ec.europa.eu/system/files/2016-09/company_tax_study_en.pdf.

member states such as Ireland to minimise their total tax liability[52]. For example, while Google generates significant revenues from advertisements across the EU, the lion's share of Google's revenues is booked in Ireland[53]. However, Ireland is by no means the only country that tries to attract MNEs by providing favourable tax regimes. In a report by the Special Commission on Financial Crimes, Tax Evasion and Tax Fraud in 2019, the European Parliament concluded that **seven member states had traits of a tax haven**. Besides Ireland, the list included Hungary, Belgium, Cyprus, Luxembourg, Malta and the Netherlands[54].

The EUs negative integration[55] through the creation of a Single Market, without accompanying positive integration under the form of EU-level tax rules, increases tax competition among member states and encourages aggressive tax planning by MNEs. Firstly, this situation has adverse effects on the EU's overall tax revenues, which are lower compared to other OECD countries[56]. Secondly, it causes distortions in the Single Market, which are particularly harmful to local businesses operating in only one member state. In the EU, enterprises compete in the same market but are located in different member states with varying rates of tax. This impacts the competitiveness of local businesses that are not based in tax havens. An indicative example is the 2014 dispute between Google and the Czech-based search engine Seznam, which, despite having approximately the same share in the online advertising market,

[52] Tang and Bussink. 2017. EU Tax Revenue Loss from Google and Facebook. Available at : https://www.actuel-direction-juridique.fr/sites/default/files/eu-tax-revenue-loss-from-google-and-facebook_0.pdf.
[53] *Ibid.*
[54] European Parliament. 2019. European Parliament resolution of 26 March 2019 on financial crimes, tax evasion and tax avoidance. Available at: https://www.europarl.europa.eu/doceo/document/TA-8-2019-0240_EN.html.
[55] The removal of barriers between countries
[56] For example, the tax paid by Google as share of their revenue is between 6% and 9% outside of the EU, whereas in the EU, it amounts to only 0.36% to 0.82%. Similarly, with Facebook, the tax paid as share of their revenue outside the EU is between 28% and 34% compared to only 0.03 to 0.10% in the EU.
Bureau van Dijk. Orbis database. retrieved from: https://www.bvdinfo.com/en-gb/our-products/data/international/orbis.

paid as much as 30 times more taxes in the Czech Republic than its American competitor[57].

(In)action at the EU level

In the EU context, fair taxation is, thus, not only a primordial precondition for social spending, but it also guarantees a fair and competitive Single Market[58]. Against this backdrop, it is little surprising that the Von Der Leyen Commission listed fair taxation in the digital economy as one of its top priorities[59]. Over the past ten years, the Commission has launched several initiatives aimed at ensuring fair taxation in the digital age. However, due to a **lack of unanimity**, none of them has been implemented to this day[60]. In addition, EU action is further complicated by **external constraints**. The EU is in a difficult position to regulate tech giants. Its initiatives to levy digital taxes have led to mounting trade tensions, especially with the US, which houses most of the world's tech companies[61]. Any attempt from the EU – which does not have many large tech companies of its own- to levy taxes on mostly American tech companies generating profit in the EU market is met by heavy resistance as it would redirect profits from the US to the EU[62]. The US opposes any tax that would specifically target American tech companies[63], and

[57] Cejkova. 2018. Taxation of revenue from digital business at EU level. Avaible at: https://is.muni.cz/publication/1599176/MSU_Tereza_Cejkova_Taxation_of_Digital_Activities_in_the_EU_2018.pdf.
[58] Szczepański. 2018. Interim digital services tax on revenues from certain digital services. Available at: https://www.europarl.europa.eu/RegData/etudes/BRIE/2018/625132/EPRS_BRI(2018)625132_EN.pdf.
[59]European Commission. 2021. Fair Taxation: Commission launches a public consultation on the digital levy. Available at: https://digital-strategy.ec.europa.eu/en/consultations/fair-taxation-commission-launches-public-consultation-digital-levy.
[60] Kendrick. 2022. The Legal (Im)possibilities of the EU Implementing the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting. Available at: https://openaccess.city.ac.uk/id/eprint/27150/1/.
[61] Christie. 2021. International tax debate moves from digital focus to global minimum. Available at : https://www.bruegel.org/blog-post/international-tax-debate-moves-digital-focus-global-minimum.
[62] Christians. 2019. A New Global Tax Deal for the Digital Age. Available at : https://www.researchgate.net/publication/338200567_A_New_Global_Tax_Deal_for_the_Digital_Age.
[63] Christie. 2021. International tax debate moves from digital focus to global minimum. Available at : https://www.bruegel.org/blog-post/international-tax-debate-moves-digital-focus-global-minimum.

recent unilateral taxes introduced by France and other EU countries have been answered by the US with threats for retaliatory measures[64].

It is clear that, in the EU context in particular, there is a need to revise the current tax system, but the road to it is filled with both internal and external constraints. It is hard to predict what the EU measures might look like.[65] **Several options could be envisaged: a common consolidated EU tax base (BEFIT), or a revival of the EU digital levy, either in addition to or instead of the OECD agreement**[66]. The next part will look into what the options are for tackling to issue of digital taxation for the EU.

PLAN A: a common consolidated corporate tax base in Europe

In the ideal scenario, the EU can use the deal reached at the OECD level to forge further tax integration within the Union. The Commission has stated that it will not only implement the OECD agreement[67] but that "a closely integrated European Union and Single Market can and should go further"[68]. In this context, the Commission noted that it would launch a proposal called **BEFIT**, which is expected in the second half of 2023[69]. The proposal, which would introduce both a common tax base and a formula for allocating profits between member states, will build on the concepts in the OECD agreement[70].

[64] Allenbach-Ammann. 2021. National digital taxes and US sanctions to be withdrawn after OECD tax deal. Available at: https://www.euractiv.com/section/economy-jobs/news/national-digital-taxes-and-us-sanctions-to-be-withdrawn-after-oecd-tax-deal/.
[65] Vázquez. 2023. Digital Services Taxes in the European Union: What Can We Expect?. Available at: HTTPS://KLUWERTAXBLOG.COM/2023/02/14/DIGITAL-SERVICES-TAXES-IN-THE-EUROPEAN-UNION-WHAT-CAN-WE-EXPECT/.
[66] *Ibid.*
[67] Kendrick. 2022. The Legal (Im)possibilities of the EU Implementing the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting. Available at: https://openaccess.city.ac.uk/id/eprint/27150/1/.
[68] European Parliament. 2023. Business in Europe: Framework for Income Taxation (BEFIT). Available at : https://www.europarl.europa.eu/legislative-train/theme-an-economy-that-works-for-people/file-befit.
[69] *Ibid.*
[70] *Ibid.*

While the practical implementation will likely differ, both the Inclusive Framework and BEFIT are based on allocating taxable profits according to a formula (Pillar 1 of the OECD agreement) and a common base[71] or rule book on how firms should calculate their profit (Pillar 2)[72]. A CCCTB is the least implemented solution thus far, but it has the greatest potential for addressing the deficiencies of the current system[73]. The introduction of one single system and accounting at the EU level could close loopholes for aggressive tax planning and substantially reduce compliance costs for enterprises[74].

Overcoming unanimity

Even though the EU is a vocal advocate of (global) tax reform, it is far from certain that it will be able to advance its own tax ambitions. **A number of difficulties threaten the uniform implementation of the inclusive framework and the pursuit of further integration**. Firstly, not every EU member state is part of the Inclusive Framework. Secondly, some EU members (namely Estonia, Hungary and Ireland) received carve-outs at the OECD level[75]. Because EU legislation in the field of taxation requires unanimous agreement, the carve-out countries will likely demand that this differentiation is replicated at the EU level[76]. The EU has only limited consequences in the domain of taxation. Nevertheless, there exist several options to overcome this hurdle.

---

[71] It is important to note that once the taxable profits are distributed, the member states would still be able to tax the profits according to their own tax rates.
[72] European Parliament. 2023. Business in Europe: Framework for Income Taxation (BEFIT). Available at : https://www.europarl.europa.eu/legislative-train/theme-an-economy-that-works-for-people/file-befit.
[73] Janský. 2018. Estimating the revenue losses of international corporate tax avoidance: the case of the Czech Republic. Available at: https://www.tandfonline.com/doi/full/10.1080/14631377.2018.1443243.
[74] Baert. 2022. Corporate taxation reform: What comes next?. Available at : https://www.europarl.europa.eu/RegData/etudes/ATAG/2022/733699/EPRS_ATA(2022)733699_EN.pdf.
[75] Kendrick. 2022. The Legal (Im)possibilities of the EU Implementing the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting. Available at: https://openaccess.city.ac.uk/id/eprint/27150/1/.
[76] *Ibid.*

One way would be to circumvent the unanimity rules and base the implementation of the global tax reform on an article that requires qualified majority voting (QMV)[77]. However, this option is likely to be legally challenged by the carve-out countries (namely Estonia, Hungary, and Ireland)[78]. The best– and likely only way, therefore, would be to use the provisions of the **enhanced cooperation mechanism**[79]. While it is little used and should be considered a last resort option[80], the EU would, in this case, fit the criteria to activate the mechanism[81]. Enhanced cooperation would not provide complete uniformity at the EU level. Yet, with the current division of competencies, it may be the only possibility for an EU implementation of the Inclusive Framework and, ultimately, further integration[82].

PLAN B: EU Digital levy

Besides the possibility of a common consolidated corporate tax rate, it is not impossible to see a **revival of the DST**, either instead or in addition to other OECD and EU measures. A Digital Services Tax is aimed at taxing revenue from digital activities of companies that operate in the EU, even if they are not physically present here. The tax was proposed for the first time in 2018. However, due to internal disagreement and external critique, it was never implemented. In 2020, it was proposed again in an attempt to raise more revenues for the recovery from the pandemic, but this time suspended to not endanger the OECD negotiations[83].

---

[77] *Ibid.*
[78] Kendrick. 2022. The Legal (Im)possibilities of the EU Implementing the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting. Available at: https://openaccess.city.ac.uk/id/eprint/27150/1/.
[79] *Ibid.*
[80] *Ibid.*
[81] At least nine member states would participate (1) , an EU wide solution was attempted first (2), and there was no perspective for a solution within a foreseeable time (3).
[82] Kendrick. 2022. The Legal (Im)possibilities of the EU Implementing the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting. Available at: https://openaccess.city.ac.uk/id/eprint/27150/1/.
[83] Mehboob. 2020. EU may keep DST even after the OECD finalises digital tax plans. Available at : https://www.proquest.com/docview/2467513452?pq-origsite=gscholar&fromopenview=true.

However, the proposal is not definitively withdrawn, and talks could resume in the future. A digital levy requires a less comprehensive reform of the EU tax rules, which might be easier to implement. Therefore, it is sometimes seen as an **interim measure** while awaiting a more far-reaching reform[84].

While welcomed by some, the idea of a digital levy is **not uncontroversial**. Within the EU, there exist considerable differences in opinion[85]. In general, larger EU countries (including Germany, France, Italy, and Spain) have welcomed the idea in the absence of a global consensus[86]. For smaller member states, on the other hand, the **administrative and compliance costs might outweigh the revenues collected from the tax**[87]. In addition, scholars have warned that an EU digital levy will likely have distortive effects and increase the complexity and administrative burdens[88] while creating legal uncertainty. Moreover, the measure could be politically hard to reverse[89]. And while the Commission states that the new version of the tax would be less discriminatory than previous versions and could exist in parallel with the Inclusive Framework – an opinion shared by some legal experts[90] - its introduction would certainly lead to the revival of international tensions, especially with the US. Despite these risks, the Czech presidency warned in

[84] OECD. 2018. Tax Challenges Arising from Digitalisation – Interim Report 2018. Available at : https://www.oecd-ilibrary.org/docserver/9789264293083-en.pdf?expires=1676368473&id=id&accname=guest&checksum=5C7B113BFFE094CF26961C76D9CE29ED.
[85] Szczepański. 2018. Interim digital services tax on revenues from certain digital services. Available at: https://www.europarl.europa.eu/RegData/etudes/BRIE/2018/625132/EPRS_BRI(2018)625132_EN.pdf.
[86] *Ibid.*
[87] Kofler and Sinnig. 2019. Equalization Taxes and the EU's 'Digital Services Tax'. Avaiable at : https://kluwerlawonline.com/api/Product/CitationPDFURL?file=Journals\TAXI\TAXI2019017.pdf&casa_token=B5l7MfQrNpAAAAAA:A-SRkWtjfMBedwwB6y1_HB2EViF0-XbzO7s7G-xibcMZ1PE-YXtQOn2C_yiJjPqX4e-yjjmg_w.
[88] Becker and Englisch. 2018. EU Digital Services Tax: A Populist and Flawed Proposal. Available at: https://kluwertaxblog.com/2018/03/16/eu-digital-services-tax-populist-flawed-proposal/.
[89] Szczepański. 2018. Interim digital services tax on revenues from certain digital services. Available at: https://www.europarl.europa.eu/RegData/etudes/BRIE/2018/625132/EPRS_BRI(2018)625132_EN.pdf.
[90] Rajathurai and Bartels. 2021. Does the international agreement on the OECD pillars mark the end of trade wars on digital taxes?. Available at.https://www.freshfields.com/en-gb/our-thinking/knowledge/briefing/2021/09/does-the-international-agreement-on-the-oecd-pillars-mark-the-end-of-trade-wars-on-digital-taxes/

November 2022 that the EU would revive talks on a digital levy if the OECD agreement was not implemented[91].

National Levies, an (effective) plan C?

Standstill at the international level and growing consciousness among the public, combined with financial strains resulting from the covid crisis, have led to the proliferation of unilateral measures at the national level (both within and outside of Europe). By taxing companies based on their presence in the immobile consumer market, national governments can implement digital taxes without fear of relocation[92]. The development has been characterised by some as the unexpected reassertion of state power[93]. **If neither the OECD nor the EU is able to reach an agreement on digital taxation in the foreseeable future, it is likely to see further initiatives at the national level.**

Today as many as ten member states have planned or implemented digital levies. 15 out of 21 member states stated that more unilateral initiatives are probable[94]. The exact scope and content of the measures differ; they include taxes on online marketplaces and advertising (France), levies on digital transactions (Italy), and taxes on advertising (Hungary)[95]. In 2019, the Czech government also submitted a proposal for a DST. The legislation would introduce a tax on large foreign tech companies that generate income from advertising, the sale of data, and the

---

[91] Bertuzi. 2022. Tech Brief: AI definition & office, Data Act amendments, short-term rental rules. Available at: https://www.euractiv.com/section/digital/news/tech-brief-ai-definition-office-data-act-amendments-short-term-rental-rules/.
[92] Gelepithisa and Martin Hearson. 2022. The politics of taxing multinational firms in a digital age https://www.tandfonline.com/doi/epdf/10.1080/13501763.2021.1992488?needAccess=true&role=button.
[93] *Ibid.*
[94] Szczepański. 2018. Interim digital services tax on revenues from certain digital services. Available at: https://www.europarl.europa.eu/RegData/etudes/BRIE/2018/625132/EPRS_BRI(2018)625132_EN.pdf.
[95] Kofler and Sinnig. 2019. Equalization Taxes and the EU's 'Digital Services Tax'. Avaiable at : https://kluwerlawonline.com/api/Product/CitationPDFURL?file=Journals\TAXI\TAXI2019017.pdf&casa_token=B5l7MfQrNpAAAAA:A-SRkWtjfMBedwwB6y1_HB2EViF0-XbzO7s7G-xibcMZ1PE-YXtQOn2C_yiJjPqX4e-yjjmg_w.

mediation of services and goods in Czechia. The tax was expected to come into effect in mid-2020 but failed to be approved by the Chamber of Deputies before the end of the parliamentary term[96].

Advantage 1: a need for immediate action

While not uncontroversial[97], advocates of these national measures estimate that the current situation challenges the fairness, sustainability and public acceptability of the tax system and creates an imperative to act to make sure that the value created in a jurisdiction corresponds to the taxes paid[98]. Contrary to international solutions (at either the OECD or EU level), which are a lengthy process and of which the outcome is still uncertain, **unilateral DSTs can be implemented relatively quickly**. In addition, they could also be used as an interim solution while awaiting a comprehensive international tax reform[99].

Advantage 2: "A whip" to speed international action

Besides being a short-term solution to the current problem, the introduction of **unilateral measures could also increase the pressure to speed up negotiations at the international level**. While the opinion on whether and how the current taxation rules should be adapted to a digitalising economy differ widely, states (and the EU) have a common interest in having one single framework. In this context, it is argued that one of the main factors that motivated states to engage in the OECD talks was the proliferation of multilateral digital

---

[96] KPMG. 2021. Czech Republic: Bill for digital services tax not approved. Available at : https://kpmg.com/us/en/home/insights/2021/11/tnf-czech-republic-bill-digital-services-tax-not-approved.html.

[97] Liberini, Lassmann and Russo. 2021. The Effects of Digital Service ("Google") Taxes on Multinational Digital Platforms. Available at: https://ieb.ub.edu/wp-content/uploads/2022/02/INF-IEB-FFFP-2021.pdf#page=38 The Effects of Digital Service ("Google") Taxes on Multinational Digital Platforms.

[98] Szczepański. 2018. Interim digital services tax on revenues from certain digital services. Available at: https://www.europarl.europa.eu/RegData/etudes/BRIE/2018/625132/EPRS_BRI(2018)625132_EN.pdf.

[99] Gelepithisa and Martin Hearson. 2022. The politics of taxing multinational firms in a digital age https://www.tandfonline.com/doi/epdf/10.1080/13501763.2021.1992488?needAccess=true&role=button.

taxes[100]. As such, the introduction of national levies can be useful as it serves "as a whip" to push for a global or European consensus.

Limitations: is the game worth the candle?

While taxes on certain transactions in the digital economy are already a common phenomenon[101], DSTs have proven to be a particularly controversial measure and have led to mounting international tensions over trade, especially with the US. In addition, a major concern of unilateral DSTs is that they might not generate as much additional revenue as hoped[102]. There are also concerns that introducing unilateral DSTs can incur implementation and administrative difficulties and harm small businesses due to rising digital advertisement prices[103]. In addition, the proliferation of similar but slightly differing taxes can further fragment the Digital Single Market, undermine the level playing field, and create new loopholes for tax avoidance[104]. Lastly, there is a chance that the unilateral measures will be only short-lived, as they will have to be repealed in case an agreement is found at the OECD level[105].

The various limitations associated with unilateral DSTs raise the question of whether the game is worth the candle.

[100] Rajathurai and Bartels. 2021. Does the international agreement on the OECD pillars mark the end of trade wars on digital taxes?. Available at: https://www.freshfields.com/en-gb/our-thinking/knowledge/briefing/2021/09/does-the-international-agreement-on-the-oecd-pillars-mark-the-end-of-trade-wars-on-digital-taxes/.
[101] e.g. online gambling and taxes on the sharing economy to collect tourist taxes
[102] Liberini, Lassmann and Russo. 2021. The Effects of Digital Service ("Google") Taxes on Multinational Digital Platforms. Available at: https://ieb.ub.edu/wp-content/uploads/2022/02/INF-IEB-FFFP-2021.pdf#page=38 The Effects of Digital Service ("Google") Taxes on Multinational Digital Platforms.
[103] Liberini, Lassmann and Russo. 2021. The Effects of Digital Service ("Google") Taxes on Multinational Digital Platforms. Available at: https://ieb.ub.edu/wp-content/uploads/2022/02/INF-IEB-FFFP-2021.pdf#page=38 The Effects of Digital Service ("Google") Taxes on Multinational Digital Platforms.
[104] Kofler and Sinnig. 2019. Equalization Taxes and the EU's 'Digital Services Tax'. Avaiable at : https://kluwerlawonline.com/api/Product/CitationPDFURL?file=Journals\TAXI\TAXI2019017.pdf&casa_token=B5l7MfQrNpAAAAAA:A-SRkWtjfMBedwwB6y1_HB2EViF0-XbzO7s7G-xibcMZ1PE-YXtQOn2C_yiljPqX4e-yjjmg_w.
[105] Liberini, Lassmann and Russo. 2021. The Effects of Digital Service ("Google") Taxes on Multinational Digital Platforms. Available at: https://ieb.ub.edu/wp-content/uploads/2022/02/INF-IEB-FFFP-2021.pdf#page=38 The Effects of Digital Service ("Google") Taxes on Multinational Digital Platforms.

The various limitations associated with unilateral DSTs raise the question of whether the game is worth the candle. The answer may differ depending on the size and economic system of a country. Also, political considerations – like public support for the tax system- can vary depending on the national context. However, unilateral DSTs should always be regarded as a **third-best option**[106].

[106] OECD. 2021. Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy. Available at : https://www.oecd.org/tax/beps/faqs-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2022.pdf.

Recommendations

1. A ‘global’ solution: ensuring the implementation of the Inclusive Framework

Firstly, **it is crucial to ensure that the OECD agreement is implemented**. The tax challenges related to the digitalisation of the economy are global in scope. Therefore, an international approach is to be preferred as it will most effectively prevent loopholes while avoiding trade tensions. Even a European solution would still be of a local nature, allowing loopholes to persist while potentially negatively impacting business. Therefore, it is crucial that, in the coming months, EU countries push for the actual implementation of the OCED Inclusive Framework.

Negative integration (through the internal market and free movement of capital) without accompanying positive integration will perpetuate cutthroat tax competition among EU member states and encourage aggressive tax planning by digital MNEs.

2. A need for further EU tax integration

Secondly, the EU member states must strive to **implement the OECD agreement at the EU level**. Not only is it the best way to guarantee uniform implementation, but it also facilitates much-needed further EU integration in the field of taxation. Negative integration (through the internal market and free movement of capital) without accompanying **positive integration** will perpetuate cutthroat tax competition among EU member states and encourage aggressive tax planning by digital MNEs. Therefore, in addition to OECD implementation, the EU must strive for a common consolidated corporate tax base. This includes a single rule book on how companies should calculate their overall profits, the possibility of adding up net profits or losses for the entire EU, and the allocation of their taxable profits between the member states through a formula. In this respect, the proposal for **BEFIT** – which is expected in the second half of this year - is an opportunity not to be missed. It is the best way to close existing loopholes and provide a just tax system while also contributing to a Digital Single Market through common rules and by cutting red tape and compliance costs for companies.

3. Decision making: QMV for tax matters

Thirdly, in the longer term, the EU needs to introduce **QMV for tax matters** so that it can tackle current and future problems that are – due to the existence of the internal market – inextricably linked to the EU level. However, the EU is currently confronted with a lack of unanimity; and it cannot afford to wait. Therefore, while awaiting institutional change, the EU should dare to consider **enhanced cooperation** as a second-best option. In the present case, it might be easy to fulfil the criteria to enact this mechanism. While an EU-wide solution remains ideal, enhanced cooperation would at least provide some level of uniformity while preventing more – potentially harmful and less effective- unilateral measures.

Outlook: what will the future bring?

The emergence of the digital economy and digitalised business models poses fundamental economic and social challenges in many domains, from the organisation of work to the international tax system. In recent years, the developments in the digital economy and the emergence of highly profitable digital platforms (such as Facebook and Google) have led to mounting criticism of the international tax system – that is based on physical presence – and a growing demand for reform. As global and highly digitalised MNEs heavily rely on mobile and hard-to-value intangible assets, profits are increasingly taxed in the wrong jurisdiction, and a growing number of services also remain untaxed. Consequently, today's most digitalised and valuable MNEs systematically pay the lowest taxes.

The need for extra funds after the pandemic, and increased awareness among both the policymakers and the public, have led to a renewed interest in fair taxation. Tax measures on various levels are currently being discussed, the most **significant of which is the OECD Inclusive Framework** that aims to fight tax base erosion and make the international tax system fit for the global age. If implemented, the agreement could be the most fundamental tax reform in a century. It would introduce market-country taxation as the new dominant paradigm and serve as a stepping stone for further EU tax integration. However, there is increasing scepticism as to whether the agreement, especially pillar one, will be implemented.

In addition to the OECD negotiations, there is a possibility that the EU would revive its plans for a **common consolidated tax base (BEFIT)**, which would build on the Inclusive Framework in case the agreement is implemented. Moreover, the introduction of a less comprehensive EU digital levy - either instead or in addition to a common tax base - remains a possibility. However, also the EU is plagued by disagreement, and the **unanimity requirement severely limits its possibilities to act**. The best and possibly only way forward, therefore, would be through **enhanced cooperation.**

Lastly, if both the OECD and EU would fail to find an agreement on how to tax the newly emerged digital companies, it is likely to see **the further spread of unilateral taxes on digital services**. While national taxes could be implemented in a relatively short term, they also leave more room for loopholes, could hamper the functioning of DSM, and there are concerns about their fundraising ability. Therefore, national levies should always be considered a third-best option.

In conclusion, the situation in digital taxation is evolving quickly**. A window of opportunity** has opened that has the potential to change the current consensus on taxation. However, many outcomes are possible, and it remains to be seen which, if any, initiative will be successfully implemented.