

Digital Service Taxes and the Broader Shift From Determining the Source of Income to Taxing Location-Specific Rents

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Wrong panel for this paper? (Although if so, it's my fault)

By word count, under 14% of this paper (at the back) discusses DSTs.

But it's in the title & loomed larger in the paper's early planning stages.

Less about DSTs as such than why they've become prominent (& may not be as bad as many assert).

No time to present the entire paper in 13 minutes anyway.

So I'll focus this talk more on DSTs than the paper does, but hint/gesture at broader topics of interest.

The “4 Horsemen” / FAANG

A big recent story is the rise of super-profitable, mainly US MNCs that use IP to (a) reap large global profits, (b) pay low global taxes.

E.g., the “4 Horsemen” (Apple, Amazon, Facebook, Google), aka “FAANG” if we add in Netflix.

Often are technology companies – but not always (e.g., Starbucks).

High profits/low taxes bound to inspire pushback, & perhaps all the more so when so prevalently outbound from the US.

Limited US residence-based taxation added to the insult, if not the injury, to EU countries that found source-based taxation challenging to apply.

Source taxation difficulties re. FAANG et al

One or more of the following often permit highly profitable IP-driven MNCs to avoid source-based taxation:

- Permanent establishment (PE) rules,
- Transfer pricing between local & outside affiliates,
- Intra-group cash flows such as interest & royalties.

Two-sided markets (a la Facebook & Google) can cause profits from access to domestic users to depend on \$\$ paid by non-residents.

But consider a mundane example in which only 2 of the above 4 issues arise: Starbucks' bricks-&-mortar UK stores.

Can't measure Starbucks' UK-source income without defining source!

Source in theory

Sourcing income not a “category error,” orthogonal to but not in tension with defining economic income. (NYC rooftop garden example, Tagalog novel example.)

But neither logic nor consensus allows choosing between production-based and market-based theories.

Each of those 2 resolutions has its own problems, but in principle these are smaller than we sometimes think.

E.g., we know where leading US MNCs actually created valuable IP under a production-based view. (Hint: their overseas cost-sharing affiliates did nothing that wasn't mundane.)

Bilateral monopoly profit-split puzzles are fun but often irrelevant.

Production vs. market-based views in practice

Starbucks claimed to be losing ££ in the UK – despite having 988 stores there (246 in London alone).

Used transfer pricing, royalty/interest flows to create fake UK losses.

But were significant ££ earned there, under a production-based view?

Clearly not – just routine / normal returns. US-created IP, US-monitored “Starbucks experience,” not based on finding unique baristas.

Still, once large profits are being earned through UK stores, (a) the UK tax authorities have a shot, (b) UK voters & policymakers may want a decent share, & (c) who can blame them?

No time to discuss this today, but ...

Among the main issues addressed in my paper are:

(1) OECD efforts to revivify source, often without addressing the tension between production-based & market-based views.

(2) Efforts such as RPA-I & the DBCFT to assign taxing jurisdiction to market countries w/ a refreshing lack of regard to source theory/debate.

RPA-I & DBCFT have virtues, but might fall short of allowing market countries to reach MNE rents or quasi-rents as fully as they might like.

They also might in practice (unintendedly) apply unequally as between firms or industries with distinct business models. Hence, still room for supplementary tax instruments.

Digital service taxes: a few issues

Two-sided business model: not fundamentally new or important, but undermines separately relying on the user-side transaction. (Cf. difficulties in taxing financial services, where have 2 linked transactions between the same 2 parties.)

Selective application: may want to vary by industry; tax planning opportunities may vary anomalously under “neutral” taxes.

Gross revenues: platform companies may have low marginal costs, note use of deductions to shift profits to tax havens.

User participation or non-participation: of zero normative interest, although made seemingly relevant by undue reliance on “source.”

Anti-American? (As discerned from hand-tailored revenue thresholds): Who’d a thunk it? But not a great time (on either side) to pick fights.