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INSIGHT: Taxing Digital Services More Heavily Is Bad Environmental Policy (and Bad Tax Policy)

BY JEFFERSON VANDERWOLK

France's finance minister, Bruno Le Maire, recently reiterated his periodic call for higher taxes on digital services companies. While perpetuating the unfounded narrative that information technology companies pay far less tax than other types of businesses, Le Maire suggested that the digital sector is reaping windfall profits from the current boom in the use of online services resulting from widespread stay-at-home orders. Therefore, he concluded, it would make sense to tax digital services more heavily. In countries such as Indonesia and Brazil, legislators have recently moved forward with new digital services tax proposals on the same rationale.

In a previous Insight article, the author argued that imposing higher taxes on automated digital services businesses in the current economic circumstances would actually be misguided. Digital services are a crucial part of the infrastructure required for economic activity during the lockdowns and for powering the broad economic growth that will be needed to restore health to the world economy in the coming months and years. It follows that digital services should not be singled out for heavier taxation, since targeted taxes discourage the use and development of the product or activity being targeted.

Moreover, it is not clear whether greater use of online services for teleconferencing, video streaming, and the like is actually resulting in greater profits for the service providers. Digital businesses have invested, and continue to invest, hundreds of billions of dollars in the physical technology assets (such as massive data centers), and in the ongoing research and development, that enable provision of the online services that we all enjoy. Increased usage of the services involves increased costs for the companies but not necessarily increased revenues.

Another argument for not imposing special taxes on the digital sector is that there are significant environmental benefits from automated digital services. Cloud services providers, for example, have adopted internal policies in favor of using electricity from renewable sources to power their data centers, and are increasingly locating data centers where the servers can be kept cool with minimal reliance on air conditioning. In addition, the use of centralized cloud computing and data storage services is far more CO_2 efficient and energy efficient, throughout the entire supply chain, than the alternative of on-site computing and storage by businesses of all sizes.

Remote working also helps the environment by minimizing business travel. Many business commentators are predicting that one effect of the Covid-19 pandemic will be a widespread increase in the amount of teleworking, in all relevant sectors of the economy. The strangely clear skies and lightly traveled roads that we are now seeing in previously polluted and traffic-clogged cities may become the norm as more and more people work from home. This can happen only because of the online services provided by the private sector.

Thus, targeting digital services companies with higher taxes would be misguided from an environmental policy perspective as well as a tax policy perspective. A good environmental policy calls for higher taxes on activities that produce carbon emissions and other forms of pollution that have social and economic costs.

Clearly, such a policy would not be consistent with higher taxes on the provision of digital services, which are environmentally friendly.

Currently, the OECD Centre for Tax Policy and Administration is leading a global tax policy project on the tax challenges of digitalization. As part of this project, the G20 and a broader group made up of 137 countries have endorsed, on a ''without prejudice'' basis, the concept of allowing countries to tax automated digital services companies whose services are used in the country even if the companies have no offices or employees in the country and collect no revenue from customers there. This would be accomplished using new rules that depart from long-established principles of international taxation regarding both nexus (i.e., taxing jurisdiction) and profit allocation (which is normally based on the arm's-length principle).

So far, the project has followed a twisting path, leaving international tax policy experts somewhat confused as to the rationale underlying the proposals regarding digital services. Initially, it was agreed that targeted rules applicable to a ''ring-fenced'' digital sector would not be practicable, because digital technologies are being used in an ever-increasing number of industries. Therefore, it was said, the digital economy is the entire economy. However, the project was not abandoned but rather took on political importance after a number of European countries, including the U.K., moved forward with plans to enact targeted taxes on digital services. The U.S., concerned about the discriminatory effect of such taxes, which would apply disproportionately to U.S.-based companies, encouraged the idea of finding multilateral agreement at the OECD on new rules that would apply broadly across all industries, while precluding unilateral digital services taxes.

The political dynamics, however, have led to a murky situation in which some countries want the new rules to be targeted at digital services, while others (such as the U.S. and China) oppose such ringfencing. A political resolution is not expected until October 2020 at the earliest. Given the economic crisis caused by the Covid-19 shutdowns, the question of imposing a special tax on digital services has become more important than ever. For the reasons given above, imposing higher taxes on the sector would be both bad tax policy and bad environmental policy.

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