EUROPEAN INTEGRATION 04.07.2018 | Gabriel Zucman

Towards real taxation of the digital giants

Paying tax where they make profit - it's as simple as that for Apple, Google and co

Read this article in German or Russian.

As we all know, technology multinationals do not pay a lot of taxes in Europe. Google, Facebook and Apple, among others, have specialised in fictitiously locating their operations in territories or countries where corporate taxes are low or even practically zero. In order to restrict these tax avoidance strategies, the European Commission has proposed taxing digital technology companies with a rate of 3 per cent of their revenues.

This plan was presented in Brussels by Pierre Moscovici, the EU Commissioner for Economic Affairs. However, even if this tax is ever implemented (which is far from certain at the moment, as Ireland, Luxembourg and Malta are opposing it with complete impunity), it is no more than a cover-up. The European Commission recognises this openly. In its opinion, it is only a provisional measure pending a reform of greater scope that has been in limbo since ... 1975.

The most promising approach consists of changing the way taxable profits are calculated in every country.

Let's recap. Due to financial globalisation, tax avoidance opportunities for large companies have multiplied. They are now making enormous profits in a handful of tax havens, headed by Ireland, Luxembourg, The Netherlands, Singapore, Hong Kong and Bermuda. Worldwide, more than 40 per cent of profits made by multinationals are artificially moved to these territories. That amounts to EUR 600 billion of profits made in France, The United States or in large emerging countries, but registered, and hence taxed (at near-zero levels), in those states offering advantageous tax rates.

This practice affects all sectors of the economy, from the pharmaceutical industry to the financial sector and from the automotive to the textile industry. We need to recognise that the giants of Silicon Valley have demonstrated great inventiveness in their set-ups. Google Alphabet, for example, registered almost USD 20 billion in profits in Bermuda in 2016. However, contrary to a widely held view, tax optimisation is not the prerogative of technology companies. That's why the 3 per cent tax is nothing but a fig leaf. Even if it were passed, the underlying problem would persist.

Taxing where you make the profits

So, what to do? The most promising approach consists of changing the way taxable profits are calculated in every country. Concretely, we propose taking the overall profits of companies worldwide and redistributing them among states while using a system of formulary apportionment based on the value of sales realised in every country.

If Apple, for example, made 10 per cent of its total sales in Germany, 10 per cent of its overall profits would then be subject to taxing in Germany. With this approach, it would be impossible to make disproportionate profits in Ireland or Bermuda. Because even though companies can nowadays easily choose the location of their profits, they do not control the location of those of their clients, who cannot send them off to the Cayman Islands that easily.

This solution is specifically appropriate for digital companies. Continuing with the example of Apple in Germany, the Ministry of Finance knows exactly how much all the computers, phones, tablets and digital services sold on the domestic market are worth. The end clients of these multinationals are also well identified, as this information is used to apply VAT.

Cooperation is always preferable, of course. But, does it make sense to wait until Ireland and Luxembourg change their minds?

Introducing a system like this in the European Union has been debated for various decades. We are talking about the implementation of the so-called Common Consolidated Corporate Tax Base (CCCTB). For these same decades, Ireland, Luxembourg and the other tax havens in the EU have been opposing this system that would put a stop to their development strategy based on fiscal dumping.

But the opinion of the governments of tax havens is not binding. There is nothing stopping Germany, France and the other European countries

from moving forward to adopt this reform unilaterally. These governments could demand that the companies that operate in their countries provide them with information about their overall profits and the sales realised in their territories, enough information to be able to calculate the taxes owed. Companies that refuse to provide these basic accounting numbers would then be denied access to the market in these countries.

Cooperation is always preferable, of course. But, does it make sense to wait until Ireland and Luxembourg change their minds? The political risk is real, because globalisation is not very likely to have a great future, if those who make the highest profits see their taxes go down while those who suffer the impacts of globalisation the most see theirs go up! The Trump vote in the United States or the Brexit vote in the United Kingdom can already be seen as a reaction to this situation.



Gabriel Zucman
Berkeley, CA

Gabriel Zucman is an economist and assistant professor at the University of California.He has published numerous scientific articles on tax issues and wealth inequality.Zucman is also the author of the 2013 book *La richesse cachée des nations / The hidden wealth of nations* and publisher and co-founder of the semi-annual *Regards croisés sur l'economy.*He is a member of the Independent Commission for the Reform of International Corporate Taxation (ICRICT).