

The new Google tax: an experiment in taxation policy

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The recent proposal of the Spanish government, to tax the income generated in Spain by the major digital companies, is an effort aligned with that of other European Union neighbours to prevent possible evasion and erosion of the tax base. A laudable objective, and one shared by the whole world's tax authorities. But it is as well to remember that tax reforms, while easy to announce, tend to be difficult to implement effectively. And the complexity has increased with the explosion of the digital economy and the consequent appearance of unfamiliar market dynamics and greater economic interdependencies among countries.

The challenge posed by the digital companies alluded to by the Minister of Finance is a good example for understanding the growing complexity facing those seeking to implement sound economic policies. These companies explain that the revenues obtained in countries where they act serve only to cover the costs of "intellectual property and other intangibles" (assets which in many cases are conveniently located in tax havens). This argument has been crucial in reducing their tax burden, underpinned by one of the basic precepts of international law and tax conventions of the last century: companies pay tax on their profits in the place where they "generate value", not where the revenue is received.

The majority of countries have solid domestic institutional arrangements for dealing with tax ruses. But the digital companies, with their high level of intangible capital and the lack of physical presence, have made these processes hugely more difficult. That is why they find it easy to argue that all the value they generate is created in a room with twenty people located in whatever country they consider convenient.

Some multilateral bodies, such as the OECD, are making significant progress in trying to avoid disputes that fuel distrust and may trigger trade wars. But forming a consensus is always a slow process when the various differing views are difficult to corroborate empirically. By way of example, in the debate about the profits of the digital companies, a key point is whether the "use" of digital services generates value for them. Some experts assert that it does, since the users of the digital services generate value for the digital companies through the so-called "network effects": the mere existence of a new user increases the utility of the rest of the digital participants. Looked at in this way, the companies generate value in the jurisdictions where their users are and therefore it is legitimate for the respective governments to tax the associated profits. But how to quantify this generation of value remains a problem.

Just to complicate things further, other experts think that the real value is not in the "use" but in the "information" that users provide to the network. In their opinion there is a simple exchange between the companies that provide digital services and the users who provide their data as input. This reasoning implies that taxing the profits of the digital companies would be equivalent to Saudi Arabia's taxing companies that use its oil as an input. In this exchange governments could collect taxes, not on companies' profits but by an increase in taxable income or by charging VAT on resident users' consumption.

These reflections help us to see part of the complexity associated with preserving world harmony based on clear rules, which is a vital ingredient for the smooth operation of any economy that is open to the world.

That said, there are many other questions relating to the effectiveness and efficiency of this and indeed any tax reform. For example, could this change have the unintended effect of discouraging the entry of new companies, consolidating the monopolistic power of the existing ones?

In any case, the complexity pointed out here must not serve as an excuse for inaction. Experiments such as this “Google tax” are valid providing that we do not lose sight of the overall picture, that there is frequent and objective assessment, and that there is permanent readiness to correct and rectify depending on the evidence. This is the only viable way to move forward in an ever more complex digital world.

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