Tax Facts

A knowledge-based series by the Tax and Transfer Policy Institute

What is a digital services tax?

A digital services tax (DST) - sometimes referred to as a GAFA (Google, Amazon, Facebook, Apple) tax - is a tax on the revenues of foreign digital goods and services.

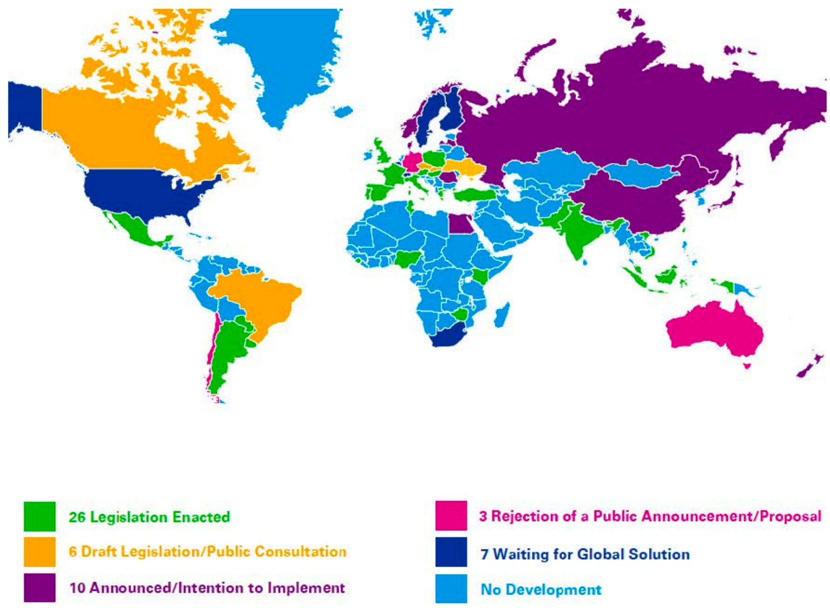
Why introduce a DST? Why have they emerged?

Revenue generated by Australian digital companies is currently subject to corporate income tax in Australia because they have a physical presence – referred to as a permanent establishment – in Australia **[see our Tax Fact #22, "Principles of international tax"]**.

By contrast, foreign owned digital businesses (FODB) pay little to no corporate income tax in Australia because, while they generate significant profit from Australians who consume the digital services they provide, they lack a physical presence in Australia. This is possible since FODBs rely on intangible and highly mobile assets, which can be located anywhere in the world.

DSTs aim to tax FODBs, which lack a physical presence in Australia, on the sizable and growing profits generated by their users in Australia. While the OECD is formulating an internationally coordinated approach to taxing multinational digital corporations, some countries have moved forward with their own unilateral DSTs. As of October 2021, legislation had been enacted in 26 countries [1].

Figure 1. DSTs across the globe



Source: Taxation of the digitalized economy, KPMG, 2021.

Who pays for DSTs? What is the economic incidence?

DSTs would tax FODBs by taxing particular revenue streams, including advertising, intermediation, and digital marketplaces and data transmission. In practice, implemented DSTs have a high tax-free threshold, thereby only applying to the largest FODBs, such as the GAFA companies. However, DSTs achieve this not through corporate income taxation, but rather a consumption tax.

Who ultimately pays for this consumption tax? The economic incidence **[see our Tax Fact #11, "Economic Fundamentals: Tax Incidence and Elasticity"]** of a DST depends on the elasticities of supply and demand for foreign digital services.

The demand for digital services, such as the use of the Apple Store or the Google search engine, is relatively inelastic since the services provided by the largest FODBs have few substitutes. By contrast, the supply of these services, such as the provision of an additional advertisement, is relatively elastic, since most investment incurred by companies for their provision is in the form of large, fixed cost investments in hardware and software development. Combined, these elasticities suggest that the burden should be shifted largely to consumers. Thus far, FODBs have responded as expected—by passing the burden down to consumers in the form of higher fees in the countries that impose them [2].

How does Australia currently tax digital goods and services?

In July 2017, Australia extended its 10% GST to include imported digital goods and services, with a turnover threshold of AUD 75,000. In 2018, it was further extended to include low value imported goods (those valued at less than AUD 1,000). These measures contributed to an additional AUD 348 million in tax revenue, representing only about 0.5% of total GST revenues [3]. In response to these measures however, many companies altered their business models. For example, in 2018 Amazon redirected Australians' access from its main website to a domestic webpage to avoid the 10% import VAT [4].

What does the OECD Pillar 1 and Pillar 2 have to do with DSTs?

The OECD arrangements aim to create a new taxing right for consumer (destination) countries, to redress the mismatch between a FODB's physical location and that of its consumers. The proposal differs from DSTs in two main ways. First, the taxing right – still under negotiation as of October 2021 – extends beyond GAFA (and other digital giants) to include companies in all industries, except financial services and extractive resources. Including all companies – as opposed to just digital companies - removes the perception of an attack on U.S. companies. Including financial services and extractive resources would alienate too many countries whose support is required.

Secondly, the formula used to determine the value of the taxing right afforded to consumer (destination) countries is closer to a tax based on economic rents **[see our Tax Fact #8, "Good Tax Policy: Taxing Economic Rents"]**, rather than the consumption-based charges that DSTs apply. The economic incidence of Pillar 1 and Pillar 2 could also differ from the DST, however, this will ultimately depend on the Pillars' final design.

This Tax Fact is largely drawn from a more extensive TTPI policy brief on digital services taxation [5]. TTPI appreciates the research assistance provided by Clara Hathorne and Lucas Rutherford for the preparation of this Tax Fact.

[1] Taxation of the Digitalized Economy, KPMG, 2021.
[2] Apple, Amazon, and Google hike their developer and ad client fees to pass on the costs of paying new digital taxes in Europe, Business Insider Australia, 2 September 2020.
[3] OECD Secretary - General Tax Report to G20 Finance Ministers and Central Bank Governors, Riyadh, Saudi Arabia, February 2020.
[4] Amazon rankles Australian customers by pushing them to a local site, The New York Times, 31 May 2018.
[5] Hathorne, C & Breunig, R (2020), Digital Services Taxation: An introduction and policy options for Australia, TTPI Policy Brief 7/2020, Canberra, 2020.

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