

## **COMBATTING BASE EROSION AND**

## I. INTRODUCTION

Social media and digital platforms have increased the interconnectedness of the world by allowing for a level of communication unseen before, but it has exacerbated a variety of societal problems. Everything from unfair taxation practices and promotion of gambling in children<sup>1</sup> to creation of black markets for stolen relics has been increased by digital platforms.<sup>2</sup> This note seeks to first shed light on the issues surrounding base erosion and profit shifting and subsequently advocate for the recognition of “user created value” to combat it. Base erosion and profit shifting allow large tech companies to pay little to nothing in taxes in countries where they conduct business.

Base erosion and profit shifting are tax planning strategies that exploit gaps in tax rules.<sup>3</sup> These strategies allow businesses that operate in multiple countries the ability to shift their profits from high-tax jurisdictions to low-tax jurisdictions.<sup>4</sup> Essentially, a company like Facebook wi

shell corporations in low tax countries. In 2017, for example, Amazon paid one tenth of one percent in taxes on its \$2.2 billion revenue in the United Kingdom by disguising its profits using a holding company in Luxembourg.<sup>6</sup>

Many European Union (EU) countries agree that base erosion and profit shifting are a problem, but they cannot agree on a uniform solution. The European Commission released its digital service tax proposal in March 2018.<sup>7</sup> This tax would apply to companies with total annual worldwide revenues of \$868 million and total EU revenues of \$58 million.<sup>8</sup> This proposal could only be passed with unanimous support of all EU members. As a result, it has not been implemented.<sup>9</sup> Ireland, Luxembourg, Malta and the Netherlands are skeptical of a digital service tax, fearing it will make them less competitive as low-tax havens for tech MNCs.<sup>10</sup>

Refusing to wait for EU cooperation, France enacted a three percent digital service tax on tech MNCs' revenues in July 2019.<sup>11</sup> The United States immediately launched investigations as it found the tax discriminatory against U.S. companies.<sup>12</sup> By August 2019, both countries reached an agreement hinging on the Organization for Economic Cooperation and Development's (OECD) tax guidelines set to be released by the end of 2020.<sup>13</sup> However, other EU countries are considering passing digital service taxes on MNCs' revenue.<sup>14</sup> Canada has also declared that it will enact a three percent tax on targeted advertising services.<sup>15</sup>

---

6. *France Tech Tax: What's Being Done to Make Internet Giants Pay More?*, BBC NEWS (July 11, 2019), <https://www.bbc.com/news/business-48928782>.

7. DANIEL BUNN, A SUMMARY OF CRITICISMS OF THE EU DIGITAL TAX, TAX FOUND. 2 (2018), <https://files.taxfoundation.org/20181022090015/Tax-Foundation-FF618.pdf>.

8. *Id.* at 3.

9. *Id.*

10. Andrew Thompson & Louis D.C. Grandjouan, *Digital Economy Taxation: The OECD's Report and European Commission's Draft Directives*, 35 J. TAX'N INVESTMENT 23 (2018), LEXIS.

11. *France Passes Tax on Tech Giants Despite US Threats*, BBC News (July 11, 2019), <https://www.bbc.com/news/world-europe-48947922>.

12. Lilian V. Faulhaber, *Beware. Other Nations Will Follow France with Their Own Digital Tax*, N.Y. TIMES (July 15, 2019), <https://www.nytimes.com/2019/07/15/opinion/france-internet-tax.html>.

13. Jim Tankersley & Alan Rappeport, *As Nations Look to Tax Tech Firms, U.S. Scrambles to Broker a Deal*, N.Y. TIMES (July 12, 2019), <https://www.nytimes.com/2019/07/12/business/economy/tech-company-taxes.html>.

14. Elke Asen, *Announced, Proposed, and Implemented Digital Services Taxes in Europe*, TAX FOUND. (Oct. 25, 2019), <https://taxfoundation.org/digital-taxes-europe-2019/>.

15. Alexander Panetta *POLITICO Pro Canada: Liberal Platform Vows French-style Digital Tax*, POLITICO (Sept. 30, 2019, 10:01 AM), <https://www.politico.com/news/2019/09/30/politico-pro-canada-liberal-platform-vows-french-style-digital-tax-011564>.

In December 2019, the investigation's findings were announced. The



2021]

*COMBATT*



Perhaps due to these tax cuts or their strong control of markets, tech MNCs revenues have surged worldwide.<sup>43</sup> With the increased revenues of tech MNCs, France realized the OECD was not working fast enough. Although the United States has responded negatively to the tax, France's DST may push countries to move more quickly in reaching a multilateral solution.

At the moment, it seems that





another class. Finally, the third class includes countries like Ireland and Luxembourg that benefit from attracting tech MNCs to set up shop in their countries due to low-tax rates.

Rather than be at odds with each other, the first- and second-class countries should bind together and propose a treaty. The United States feels its companies are being discriminated against, yet the United States is also losing out on valuable tax revenue just like France and the others. These conflicts likely prevent the OECD from making quicker decisions in the international taxation realm. A treaty or executive agreement between the United States and similarly positioned countries may be a solid step forw posi





pages browsed.<sup>72</sup> Inferred data is the information gathered from searches and purchases to determine information, such as, a user who may be pregnant or an avid soccer fan.<sup>73</sup> All this data combined allows companies a thorough look into a user's habits, lifestyle, and career. In turn, such data can be used to market specific products to a person and influence their political beliefs or purchasing habits. Thus, the "free" access the digital platforms provide is not truly "free" of cost.

Conversely, the user receives access to a highly valued product through exchanging data for services. The use of digital platforms is arguably necessary to be a fully engaged member of society.<sup>74</sup> However, at some point, a line must be drawn because consumers are handing over a lot of personalized data in exchange for information and entertainment.<sup>75</sup> Consumers are not completely giving away free labor, but there is a disconnect in the privacy they are losing and the services they are receiving. In addition, companies that mine the data are making large profits from privacy breaches.

Some scholars have argued that consumers should own their data and have the choice to decide whether to sell it or not. For example, U.S. presidential candidate, Andrew Yang, has proposed treating data as a property right.<sup>76</sup> This is important as he brought user-created value into the U.S. zeitgeist. In the United States, data gathering and marketing is a \$198 billion industry, and Yang believes Americans have not received enough in return for their data and loss of privacy.<sup>77</sup> Others have suggested viewing data creation as labor because so many jobs will soon be lost to automation in the coming decades.<sup>78</sup> Furthermore, artificial intelligence needs the constant input of others in order to become better.<sup>79</sup> It is of note that the users who input the data needed for better digital platforms create the value. Viewing data as property that can be sold is a radical approach that may one day be applicable. For now, governments must realize that users create value for tech MNCs, and this value must be taxed.

---

72. *Id.*

73. *Id.*

74. *Id.* at 155.

75. *Id.* at 160.

76. Tyler Sonnemaker, *Andrew Yang Wants You to Make Money on Your Data by Making It Your Personal Property*, MKTS. INSIDER (Nov. 14, 2019, 4:19 PM), <https://markets.businessinsider.com/news/stocks/andrew-yang-data-ownership-property-right-policy-2019-11-1028691103>.

77. *Id.*

78. Imanol Arrieta Ibarra et al., *Should We Treat Data as Labor? Moving Beyond "Free,"* 108 AM. ECON. ASS'N PAPERS & PROC. 38, 42 (2018).

79. *Id.* at 40.

The first step in pushing tech companies to be equitably taxed requires the understanding that users are creating value. Many recognize this and France is making the salient moves needed to center these values. Considering data input as labor may reach too far, but recognizing value is created by data mined from users is not. This value can be determined through annual reports by the tech MNCs that take into account the ad revenue generated in various parts of the world. Finally, if the users create value that means profits are being made simply from interactions with the social media platform inside the country. This would allow the tech MNCs to be taxed because they are actually profiting a tangible amount of money from that particular country.

*C. Understanding the Value of Data and the Tech Marketplace*

The market inhabited by tech MNCs is much different than the previous international businesses. Professor Wei Cui explains how Facebook in France offers free social media services to users all over the world as well as advertising services to advertisers for untaxed profit.<sup>80</sup> U.S. companies then purchase advertisements targeting French consumers, and Facebook profits from the American company, receiving payment in the United States.<sup>81</sup> If Facebook had a permanent establishment (PE) in France, there would be no reason to attribute the profits it earns from American advertisers to the French PE.<sup>82</sup> However, Facebook

commercial that caused the friend to buy would be difficult. Now, every click made on a website shows the consumer trends of a country.

Consumers today are not stagnant. Consumers create content which drives demand for others to join the social media platform. These people are “prosumers,” meaning they are producing consumers.<sup>86</sup> These prosumers are the ones that drive people to sites like Instagram to keep up with the constant photos the prosumer shares. France estimates 150 million posts are uploaded daily in the EU and that value, which is user created, goes into the pockets of tech MNCs.<sup>87</sup> Tech MNCs depend on a developing, active, and engaged user base. The larger the base, the more market power an MNC can wield.<sup>88</sup>

Tech MNCs are aware that users create value. The volume and quality of the content created by users is key in a tech MNC’s ability to generate revenue from other users or paid-for advertising targeted at those users.<sup>89</sup> Many users realize this and become influencers, users who create value through advertising products, and yet Instagram is beginning to slow the progress these influencers have made. Under the guise of mental health, Instagram allowed users to remove “likes,” a numerical indicator that shows how much attention a post is getting, but in reality they want to turn around and sell the analytics of “likes” to users.<sup>90</sup> Millions of dollars pass from brands to influencers weekly, while Facebook (Instagram’s parent company) does not get a share.<sup>91</sup> To combat this, Instagram is removing analytics, such as “likes,” and then turning around to sell a service to brands which shows the traffic a post gets.<sup>92</sup>

This may be a bad move as social media business models are based on encouraging users to proactively contribute content and spend time on the platform. Instagram may now find itself losing users, which in turn would mean losing profits as users switch to a platform that allows them to capitalize from their contributions.

Netflix is also aware that its users create value through the data gathered from them. At its core, Netflix is a data driven company focused on collecting

---

86. FUCHS, *supra* note 58, at 62.

87. *Projet de loi relatif à la taxation des grandes entreprises du numérique*, MINISTÈRE DE L’ÉCONOMIE ET DES FINANCES 4 (Mar. 6, 2019), <https://www.economie.gouv.fr/files/files/2019/dp-tax-gafa-v11.pdf>.

88. OECD, *supra* note 57, at 9.

89. *Id.*

90. Olivia Ovenden, *Why Is Instagram Removing Likes? It’s Probably Not to Help Your Mental Health*, ESQUIRE (Nov. 12, 2019), <https://www.esquire.com/uk/design/a29768558/instagram-removing-likes-facebook/>.

91. *Id.*

92. *Id.*





advertisers' desire to pay for ad space and diminish a platform's market power.<sup>100</sup>

Costs will rise, but that cost may not be transferred onto the consumer in certain areas. For example, due to increased taxation, a newspaper may lower, rather than raise, the price of a subscription in order to increase circulation and attract more advertisers.<sup>101</sup> The advertising profits go up and compensate readers for the increase in advertisement with a lower subscription price.<sup>102</sup> Now, in applying this to Facebook or Google, it would be best for these firms to absorb the costs or risk losing advertisers.<sup>103</sup> The more advertisers either of these sites lose, the less profitable it becomes to maintain the platform, unless the firm operates on the rare "Netflix" model of running at a deficit without ads.

The shifting of costs onto consumers may be different for sites that sell products, rather than social media providers. In response to the DST, Amazon has passed the cost onto vendors.<sup>104</sup> Legally, Amazon is the one who pays

#### IV. THE POLITICAL UNDERPINNINGS OF THE DIGITAL SERVICES TAX

As global barriers are lessened through the advancement of technology, many disparities become more apparent. Social media, through all of its collection of data, has provided a window into the affairs of other countries. It has even allowed for meddling in the political affairs of other countries. DSTs may serve to get tech MNCs to pay their share, but also to increase responsibility for the actions they take. As the OECD makes clear, base erosion and profiting have become a huge global problem.<sup>109</sup> They have allowed tech MNCs to take control of sovereign nations through the manipulation of government elections and failure to pay taxes.

France's decision to implement the DST was due in part to social unrest throughout the country.<sup>110</sup> The country erupted in protests after President Macron implemented anti-labor policy such as cutting taxes for the wealthy and large corporations.<sup>111</sup> Seeing the deteriorating conditions of his approval, Macron made concessions, including increasing the minimum wage, allowing for tax exemptions on overtime pay, and raising retiree social security.<sup>112</sup> These concessions are set to cost the French government approximately \$11.3 billion, which the DST will help to finance.<sup>113</sup> The government aims to collect \$5.5 billion annually from the proposed DST.<sup>114</sup> Although the DST alone will not solve France

begin a two percent DST as of April 2020,<sup>116</sup>

million, shows a desire to tax more than just American tech MNCs.<sup>119</sup> In truly combatting base erosion and profit shifting, the DST is not the best, but serves as a testing ground for eventually finding a way to stop all industries from artificially moving and keeping money tax free.<sup>120</sup>

Many other countries have followed France's bold move, although U.S. scholars and companies continue to argue that the DST is disastrous. It may be disastrous to large MNCs, but perhaps it will create more competition and in turn, more innovation in the tech industry. Rather than fall behind, the United States must get ahead of this growing problem and agree on a treaty to deal with these taxation issues.

The main takeaway is recognizing that users of social media platforms create value. U.S. legislators must understand this and begin to move forward in creative ways to adhere to that principle. This is the first wave in the regulation of the complex digital economy that has been created by social media. It is best that larger countries with more resources lay the foundation