The Impact of Taxation on the Digital Economy

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Digital economy taxation entails multiple issues

• Should governments tax mobile and broadband devices and services?
• What is the appropriate level of taxation imposed on capital equipment purchased by telecommunications operators?
• How should double taxation of international services be tackled?
• How should consumption of digital goods be taxed?
• Should the providers of digital platforms be taxed at the country location where revenues are generated?
Should governments tax mobile services and handsets?

- Countries follow four service and handset taxation approaches
  - Universalization: reduce taxes as much as possible to increase adoption
  - Protectionism: similar as above but substantial increase in service VAT
  - Sector distortion: include sector specific taxes
  - Tax maximization and sector distortion: high service and handset taxes to maximize government revenues
- The global average import duty rate for a PC is 2.1% ranging between 0% to 35%, while sales taxes can reach 27%
- Cumulative impact of duty, sales and specific taxes can have a 50% impact on price

The higher the tax burden, the lower mobile adoption

- Tax exemptions generate more economic benefits and tax revenues than the losses incurred by the tax exemption
Should governments tax broadband services?

- Broadband penetration faces an affordability barrier
- In general, it is considered that a broadband consumption tax increases the cost of ownership, thereby reducing adoption
- Lower subscription prices triggered by tax reduction, imply higher demand

**Impact on Fixed Broadband Penetration of Price Reduction**

<table>
<thead>
<tr>
<th>Region</th>
<th>2013 Household Penetration</th>
<th>5% Price Reduction</th>
<th>10% Price Reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub-Saharan Africa</td>
<td>3.12%</td>
<td>3.62%</td>
<td>4.11%</td>
</tr>
<tr>
<td>Americas</td>
<td>54.87%</td>
<td>57.79%</td>
<td>60.70%</td>
</tr>
<tr>
<td>Arab States</td>
<td>27.93%</td>
<td>30.10%</td>
<td>32.28%</td>
</tr>
<tr>
<td>Asia &amp; Pacific</td>
<td>31.05%</td>
<td>33.35%</td>
<td>35.65%</td>
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<tr>
<td>Europe</td>
<td>72.02%</td>
<td>75.13%</td>
<td>78.24%</td>
</tr>
<tr>
<td>CIS</td>
<td>36.94%</td>
<td>39.44%</td>
<td>41.94%</td>
</tr>
</tbody>
</table>

Source: Estimates by the author based on ITU 2013 data

Lowering taxes on broadband triggers spillovers that are larger than the foregone taxes

**Virtuous Circle of Tax Reduction on Broadband Services and Devices**

- Reduce taxes on devices and service
- Increase broadband penetration
- Higher revenues
- Greater return to scale of capital invested
- Lower broadband prices
- Higher taxes collected
- Less direct taxes
- Higher welfare benefits
- Lower government revenues in the short term to invest in public services

Source: Telecom Advisory Services analysis
Should governments collect taxes on equipment purchased by broadband providers be?

- Broadband service providers are imposed a range of taxes
  - Conventional corporate taxes (approximately 35% on gross profits)
  - Sales tax (up to 10%) and customs duty (up to 15%) on purchased equipment
  - Indirect taxes on CPE
  - Property taxes for physical assets (1.6% of assessment value)
- Sales taxes on purchased equipment have a negative impact on network deployment and, therefore, on broadband economic impact
- Accordingly, some governments have exempted ISPs from paying taxes on purchased equipment
  - Malaysia approved 100% tax allowances on “last mile” broadband equipment
  - 20 states in the US exempted sales tax from broadband equipment purchasing

Should production and consumption of digital goods be taxed?

- A country has a right to tax income by way of where the good is generated (source-based) or where it is being consumed (residency-based)
  - Digital advertising: determining the source of the income remains a critical taxation issue
  - E-commerce: a provider does not pay taxes in a country if it does not fulfill the “permanent establishment” condition
  - Video-streaming: some countries are moving to collect a tax on video-streaming services to protect local cable-TV industries
- Arguments for and against taxation of production and consumption of digital goods
  - Digital advertising: loss of tax revenues ↔ erosion of spill-over
  - E-commerce: unfair advantage ↔ enforcement difficulty
  - Sales tax on digital goods: cultural protectionism ↔ lack of harmonization
Several dimensions of taxation asymmetry

- Asymmetry between industries
  - Within the digital sector, Internet firms have a 5 (Europe) to 7 (emerging countries) percentage point lower effective tax rate (ETR) than telecommunications operators
  - Global internet players have a lower ETR than telecommunications players
  - Telecommunications players are taxed more than other service players
- Double taxation of international telecommunications services taxation of digital players with no physical presence
- The design of an efficient tax structure in the digital space needs to consider three requirements
  - Ensure proper collection of taxes for income generated at source
  - Avoid over taxation of digital activities when compared to other industries
  - Provide selective exemptions to facilitate investment in infrastructure and promote adoption by end-users

Maximizing impact on the digital economy

- Extensive evidence that digitization has impact on economic growth
- Taxation can have a detrimental impact on digitization growth
  - On consumption of digital goods
  - On equipment and other production inputs
- Taxation of digital goods and services should be approached preventing any erosion of their economic impact
- Balance short-term revenue generation and long term support of innovation and economic growth
  - Imposing “luxury taxes” on smartphones and tablets does not have any redistributive impact
  - Import duties have no clear impact in protecting domestic industries
  - Sector specific policies may be distortive