What's In a Name? EU Digital Levy Isn't a Tax, Vestager Says

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By William Hoke

Shakespeare said a rose by any other name would smell as sweet, but multinational companies aren't likely to draw the same conclusion about a claim that the EU's proposed digital levy is not a tax.

On July 2 Reuters quoted European Commission Executive Vice President Margrethe Vestager as saying that the scope of a digital revenue measure to be proposed in the coming weeks would be much wider than the recent global agreement brokered by the OECD on the taxation of multinational companies. "Just as a matter of principle, it is a levy," Vestager said. "It is not a tax."

Vestager said hundreds of companies would be subject to the digital levy, although it would mostly affect European firms. "I do appreciate that for a company, no matter what you call it, it's a cost," she added.

Matthias Bauer, a senior economist with the European Centre for International Political Economy in Brussels, said the commission's January 14 inception impact assessment for the digital levy identified "three new taxes — and taxes only — not levies."

Bauer said a tax is a financial charge on individuals or businesses collected by a government. "It's used to pay for general public spending," he said. "A levy is an obligatory payment to the government or another organization for a specific purpose. However, the use of both terms varies between governments. Depending on the legal basis, one may conclude that a levy is a tax and a tax is a levy. For the digital levy, the distinction will impact on how member states react to the commission's proposal."

Leopoldo Parada, a lecturer in tax law at the University of Leeds in the United Kingdom, said the difference between the two words can be blurry. "Considering a glass of water [to be] wine does not change its composition," he said. "Similarly, calling a 'tax' a 'levy,' even though it is still [using] a rate calculated on a particular tax base, does not change its nature, either. If the EU digital levy is a copy of the already failed directive of 2018, it is a tax on certain digital services. End of story."

Commission Executive Vice President Valdis Dombrovskis said July 6 that "the nature of the digital levy will be quite different" from the EU digital services tax proposed in 2018. He said he considers the digital levy to be complimentary to the OECD agreement, but with a broader company base.

French Finance Minister Bruno Le Maire said the same day that the term “digital levy” might not be the most appropriate for the EU proposal, which he said has nothing to do with the taxation of “digital giants.” Le Maire said that while the OECD’s proposal would apply to digital companies with annual revenues above €20 billion, the measure under consideration by the EU would cover a wider range of businesses. Some diplomats have suggested that the EU proposal would hit companies with worldwide annual turnover of at least €250 million at a rate of 0.3 percent to 0.5 percent.

Parada said Vestager appears to consider the proposed charge to be akin to either a tariff or an entrance or permission fee for providing digital services within the EU. “It works quite well for politicians; however, from a legal perspective, you still need a directive to implement this,” he said. “That is, you still need [member state] unanimity.”

Bauer agreed. “This is merely economic populism,” he said. “In the inception impact assessment, the levy is explicitly about three types of new taxes, which is why it should be called a tax, full stop. The term 'levy' only emerged as a new buzzword after the failure of the original DST initiative . . . and the massive headwinds from the U.S. and some EU member states.”

Lilian V. Faulhaber, a law professor at Georgetown University in Washington, said Vestager’s comment was “in many ways a distinction without a difference.” She added, however, that the use of the term “levy” for a charge on digital services is not unprecedented. “One of the early digital services taxes was what India referred to as its equalization levy,” she said. “It was still essentially a DST, it just used the word ‘levy.’”

India implemented the equalization levy in 2016 at a rate of 6 percent of the gross amount of any payment exceeding INR 100,000 (about $1,340) a year for nonresidents that lacked a permanent establishment in India. The levy, which applies only to business-to-business transactions, was in line with the final outcome under action 1 (addressing the challenges of the digital economy) of the OECD's base erosion and profit-shifting project. In 2020 India passed a separate equalization levy of 2 percent on foreign e-commerce operators that sell to Indian customers. The new levy does not apply if a foreign operator has an Indian PE, is already subject to the 2016 levy, or has annual sales below INR 20 million.

“If you look at the OECD publications from several years ago, they lumped it in with DSTs,” Faulhaber said. “There’s not in any way an understood distinction in the international tax space about levies being fundamentally different from taxes.”

Own Resources

Bauer said the commission wants to fund the EU budget and secure its own sources of revenue, “which is why it keeps vigorously pushing the myth that digital companies are undertaxed and need to be charged a new special tax on all sorts of digital activities.”

Faulhaber agreed that there could be a link between the digital levy and the commission’s funding needs. “The reason that they’re trying to design it right now is because they’re supposed to fund [their] own resources,” she said. “Some of the other things that fund EU own resources have also been referred to as levies.”

One of the commission’s main sources of revenue is the 0.3 percent cut it takes from each member state’s VAT base, capped at 50 percent of the country’s gross national income. “That is often, but not always, referred to as a levy,” Faulhaber said. “It may be that . . . funding own resources means that Vestager sees it through the lens of other things that are referred to as levies, which are still, of course, things that are taxes.”

Semantics aside, there could be a knottier issue that Vestager was trying to avoid by her use of the word "levy." Faulhaber said the OECD’s pillar 1 and pillar 2 agreements to modernize global corporate tax rules include commitments to eliminate all DSTs and “other relevant similar measures" imposed on all companies. “My guess here is that Vestager is trying to define this digital services levy or digital services tax in a way that the EU can keep it even though the member states have agreed to eliminate digital services taxes in exchange for pillar 1 and pillar 2,” she said. “If all the DSTs are supposed to be eliminated, the EU is going to want to create something different that doesn’t have to be eliminated, so they’re using a different word.”

Whether the United States, which has imposed tariffs on some countries over their unilateral DSTs, would accept an EU digital levy remains to be seen. “In the OECD agreement . . . the specifics of the elimination of the digital services taxes have not been prescribed yet, but it says very clearly that part of the agreement is that DSTs will be eliminated,” Faulhaber said. “That was sort of understood, [that] the carrot that countries like the United States were getting was the elimination of everybody else’s unilateral taxes in exchange for these other two pillars.”

The United States has been very clear that it is opposed to both country-level and EU-level DSTs, Faulhaber said. “So my sense is that when the U.S. recently asked the EU not to move forward with the digital levy, they were essentially just buying time in order to reach this [OECD] agreement, and I assume now we’re exactly in a situation that was predictable,” she said. “The agreement says there can’t be any taxes like this and the thing that the EU is about to propose seems very likely [to] take the form of — to use the wording of the OECD — a digital services tax 'or other relevant similar measure.'”

Faulhaber said the possibility of a conflict between the OECD negotiations and the EU’s plans for a digital levy is well known. “The commission has been made very aware of it, so I think it would be hard for them to say . . . ’We’re just doing our own thing, even though most of our member states have agreed [that] there wouldn’t be anything like this,’” she said.