EU Tax Revenue Loss from Google and Facebook

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Introduction

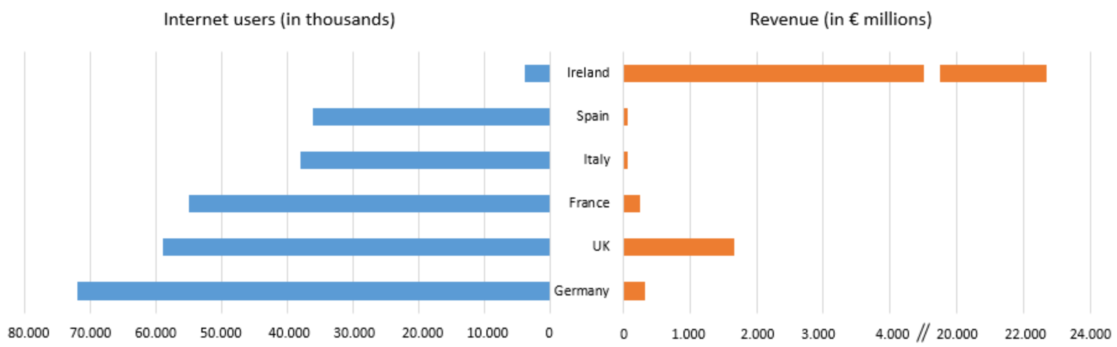
Recent developments show that the current corporate tax rules no longer fit the modern context. The business environment has become more globalized and digital, while corporate income is taxed at the national level. This incentivizes multinational firms - especially large digital platforms such as Google and Facebook - to engage in international tax planning aimed at avoiding taxes. The EU in particular seems to be vulnerable to tax planning activities by these U.S. tech-giants. The OECD/G20 BEPS-project has declared the tax challenges of the digital economy as one of the top priorities. However, no result should be expected in the short term as the US takes a biased position towards their digital companies. Therefore, Europe has to take the lead with a modern framework for corporate taxation in the EU. In this note we shed light on why such tax reform is needed, and how to make large digital platforms subject to tax. With this note we wish to provoke a more concrete discussion on this important matter.

The mismatch between revenue and users or customers

There is a huge mismatch between where revenues are booked and where users are located. For instance, large digital platforms interact online with their users all over Europe, while booking (almost) all their revenues in low-tax Member States such as Ireland or Luxembourg.

Example of Google: *Almost all of Google´s European revenues are made by Google Ireland Ltd. in Ireland where its European headquarter is located. No advertisement revenue is generated for those Member States where Google operates through a local website without having a physical office*.

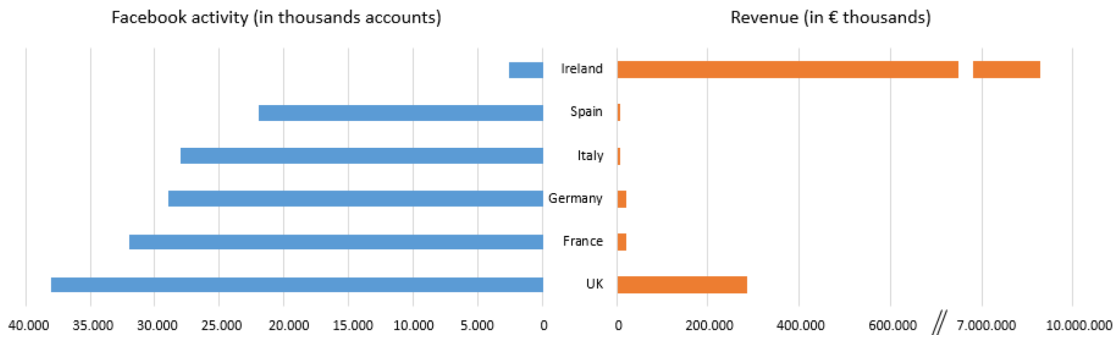
Figure 1. Google´s revenue vs. internet users in Ireland and 5 largest EU Member States, 2015



Source: *Orbis database (Bureau Van Dijk) and Internet World Stats, own projections*

Example of Facebook: *Similarly, most of Facebook´s European revenues are made by Facebook Ireland Ltd. in Ireland where also its European headquarter is located.*

Figure 2. Facebook´s revenue vs. activity in Ireland and 5 largest EU Member States, 2015



Source: Orbis database (Bureau Van Dijk) and Internet World Stats, own projections

The special case of Amazon

For Amazon the mismatch between where revenues are recorded and where customers are located is even larger. Until 2015, all of Amazon´s European revenues were booked in Luxembourg (Amazon EU Sàrl) and therefore only taxable in the Duchy, while it has several national websites. Moreover, they were not subject to tax in Luxembourg as the result of a construction which allows the company to shift is profits by royalty payments to a tax exempt partnership Amazon Europe Technologies SCS. In 2015, the European Commission launched a probe into Amazon´s Luxembourg tax deal. Following this probe, Amazon announced to start paying tax in the UK and Germany, so that future sales are booked in these countries.

Unlike Google and Facebook, Amazon almost do not make any profits, or maybe more accurate, do not report any profits. Over the period 2013-2015, we estimate the profitability of Amazon in the EU between 0.3% and 5%, with even a net loss in 2014. This is suspicious, but makes it hard to estimate the expected loss in tax revenues for the EU as we do for Google and Facebook.

The deprivation of tax revenues

Large digital platforms operate as a single unit in the EU internal market, but face a patchwork of tax jurisdictions competing for profits. This enables them to minimize the overall tax burden in the EU by routing all revenues to low-tax Member States such as Ireland and Luxembourg. Hence, the other Member States are very likely being deprived of billions of euros of tax revenues.

The tax-to-revenue ratios of Google and Facebook in the EU are out of line with those in the rest of the world (mainly U.S.). The tax paid by Alphabet Inc. (Google) as share of their revenues outside the EU is between 6% and 9%, whereas in the EU this ratio is only 0.36% to 0.82%. When we look at

Facebook this contrast is even larger. Facebook´s taxes as share of their revenues recorded outside the EU is between 28% and 34%, whereas in the EU this is a remarkably low ratio of 0.03% to 0.10% (see Table 1 in the appendix).

Tax revenue loss EU

These results are due to artificial low profits within the EU, and hence low taxes. In this note, we estimate the expected tax revenue loss from Google and Facebook over the period 2013-2015 in three different ways (see Table 2 in the appendix):

Method 1

First, we apply the profit margins of the worldwide consolidated accounts to the EU revenues to obtain an estimate of the profits that ´should´ have been reported in the EU. Subsequently, we apply the worldwide effective tax rates on these estimated profits, and take the difference with the taxes actually paid. This gives us a conservative estimate of **EUR 5.1 billion** that has been ´lost´ over the period 2013-2015.

Method 2

First, we divide the EU revenues over the Member States according to their internet and Facebook penetration in the EU in order to bring the revenues and users back in balance. Thereafter, we apply the worldwide profit margins to these revenues to get a measure of their ´real´ profits. Finally, we apply the nominal tax rates on the estimated profits, and take the difference with the taxes actually paid. This results in an estimated tax revenue loss of **EUR 5.4 billion** over the period 2013-2015.

Method 3

The forthcoming proposal of France and Germany for the ECOFIN of September, is to introduce a tax of 2% to 5% on the revenues of major digital companies. Under the assumption that this tax fully compensates for the expected losses, this means that the EU has ´lost´ between **EUR 1.6 billion and EUR 4 billion** over the period 2013-2015 based on the EU revenues of Google and Facebook over that same period.

To put things into perspective, these amounts lie somewhere between the net contribution of 2015 of Belgium (EUR 1.3 billion) and more than France (4.9 billion).

Tax revenue loss Member States

Furthermore, we estimated the loss in tax revenues from Google and Facebook for the individual Member States over the period 2013-2015.

For the 10 largest EU Member States the revenue loss is estimated at EUR 124 million (Sweden), EUR 133 million (Belgium), EUR 158 million (Romania), EUR 215 million (Netherlands), EUR 335 million (Poland), EUR 482 million (Spain), EUR 549 million (Italy), EUR 741 million (France), EUR 810 million (UK) and 889 million (Germany) (see Table 3 in the appendix).

To put it into perspective, these amounts account for 22% up to a full replacement of a one-year VAT own resource contribution of these countries.

Benchmark with Apple

The EUR 13 billion fine of the European Commission for Apple covers a 10-year period, i.e. EUR 1.3 billion of 'lost tax revenues' per year. The estimated loss of EUR 2.7-4 billion (Google) and EUR 1.5-2.4 billion (Facebook) covers a 3-year period, i.e. EUR 0.9-1.3 billion and EUR 500-800 million per year respectively.

Tax disputes between Member States and Google

As a result, some Member States have started tax investigations and settled tax disputes to make Google taxable in their jurisdiction:

- In 2015, Google settled a tax dispute in a UK tax deal with HMRC and agreed to pay £130 million. The payment covers the underpayment of UK taxes since 2005 and followed a 6-year inquiry by HRMC that accused Google of skirting UK taxes by diverting its UK revenues to Ireland, its European headquarters (Google Ireland Ltd.);
- In 2017, Google settled a tax dispute with Italy and agreed to pay €306 million that covers the underpayment of Italian taxes between 2002 and 2015. The agreement resolves a series of disputes including a criminal probe that accused Google of booking around €1 billion of Italian revenues from Italy to Ireland (Google Ireland Ltd.) between 2009 and 2013.
- Similar tax investigations have been ongoing in France and Spain but the so far disputes remain unsettled.

However, we need a coordinated European approach to taxing digital platforms within the framework of the 3TB-proposals instead of the current patchwork of unilateral decisions.

How to make large digital platforms subject to tax

The underlying problem is that the current international tax rules only create a taxing right for a jurisdiction when the business has a physical presence in that jurisdiction. The main feature of the digital economy, however, is that service are provided digitally with minimal physical presence, even in the country of residence. It is for that reason that cross-border activities of digital platforms remain untaxed in most jurisdictions where the business is digitally present and creating value. Therefore, it is high time to ensure that major digital companies become subject to tax where they generate revenues from digital platforms.

This directly relates to Action 1 of the OECD/G20 BEPS-project[1] : *"Issues to be examined include, (...), the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, (...)."*

To address the shortcomings of the current concept that leads to a taxable nexus - so called Permanent Establishment (PE) - the OECD/G20 Discussion Draft (2014) already proposed a new standard based on ´significant digital presence´[2]. However, the OECD/G20 Final Report (2015) discarded this new PE nexus by coming up with a far less ambitious approach[3]. We would rather like to see a solution that addresses the shortcomings in a way that deals with its structural deficiencies. Our focus is on how to adjust the existing PE concept to the new scenario of the digital economy. Within the 3CTB-proposal, we have therefore proposed to change the features of the PE towards a new nexus based on digital presence that is able to address the issue of avoiding a taxable presence in Member States. The specific proposal (Article 5) is reproduced in the Appendix.

Conclusion

As long as we do not adapt the outdated international corporate tax rules to the era of the digital economy, Member States are losing valuable tax revenues. Therefore, it is urgent to close the gap in the tax rules in order to ensure the fair and efficient taxation of corporate income in a digitalized economy.

[1] https://www.oecd.org/ctp/BEPSActionPlan.pdf (p. 14)
[2] https://www.oecd.org/ctp/tax-challenges-digital-economy-discussion-draft-march-2014.pdf (p. 65-66)
[3] http://www.oecd-ilibrary.org/docserver/download/2315281e.pdf?expires=1500021836&id=id&accname=guest&checksum=8C6F02952FB375C98A4C40CC536C147A (p. 12-13)

Table 1. Revenue´s, profits, tax and effective tax rates, Alphabet Inc. (Google) and Facebook Inc. 2013-2015

		Revenue (m EUR)			EBT (m EUR)			Tax (m EUR)			Tax / EBT			Tax / Revenue		
		Total	EU	Rest of the world	Total	EU	Rest of the world	Total	EU	Rest of the world	Total	EU	Rest of the world	Total	EU	Rest of the world
Alphabet Inc. (Google)*	2013	40.257	18.614	21.643	11.529	343	11.186	1.986	84	1.902	17%	25%	17%	4,93%	**0,45%**	**8,79%**
	2014	54.362	19.159	35.203	14.215	285	13.930	2.997	69	2.928	21%	24%	21%	5,51%	**0,36%**	**8,32%**
	2015	68.879	25.320	43.559	18.050	586	17.464	3.034	207	2.827	17%	35%	16%	4,40%	**0,82%**	**6,49%**
Facebook Inc.**	2013	5.720	3.069	2.651	2.001	(4)	2.005	911	3	908	46%	n.a.	45%	15,93%	**0,10%**	**34,25%**
	2014	10.299	5.017	5.282	4.057	(20)	4.077	1.628	5	1.623	40%	n.a.	40%	15,81%	**0,09%**	**30,73%**
	2015	16.410	8.253	8.157	5.670	43	5.627	2.294	3	2.291	40%	6%	41%	13,98%	**0,03%**	**28,09%**

Source: Orbis database (Bureau van Dijk) and SEC Form 10-K; Note: If reported in a different currency than EUR, the exchange rate at the closing date is used

* The data for Europe is the total of Google Ireland Ltd., Google UK Ltd., Google Germany GmbH, Google France, Google Netherlands B.V., Google Spain SL, Google Italy S.R.L., Google Poland SP Z.O.O., Google Sweden AB, Google Belgium and Google Denmark APS.

** The data for Europe is the total of Facebook Ireland Ltd., Facebook UK Ltd., Facebook France, Facebook Germany GmbH, Facebook Sweden AB, Facebook Italy S.R.L., Facebook Spain SL, and Facebook Poland SP Z.O.O.

Table 2. Estimated tax revenue loss EU, Alphabet Inc. (Google) and Facebook Inc. 2013-2015

	Method 1: **Tax revenue loss 2013-2015**	**Method 2:** **Tax revenue loss 2013-2015**	**Method 3:** **Tax revenue loss 2013-2015**	
			Tax 2%	Tax 5%
Alphabet Inc. (Google)	(2.726)	(3.955)	(1.262)	(3.155)
Facebook Inc.	(2.415)	(1.453)	(327)	(817)
Total	**(5.141)**	**(5.408)**	**(1.589)**	**(3.972)**

Note: The underlying data and calculations are retrievable via email.

Table 3. Estimated tax revenue loss for 10 largest EU Member States, Alphabet Inc. (Google) and Facebook Inc. 2013-2015

	Alphabet Inc. (Google)				**Facebook Inc.**				**Total**	
	Internet users	Internet penetration (% of total EU)	Total loss Google 2013-2015*	Loss Google 2013-2015	Facebook accounts	Facebook penetration (% of total EU)	Total loss FB 2013-2015**	Loss FB 2013-2015	Total loss Google + FB 2013-2015	% of VAT own resource
Germany	71.728	18%	(3.955)	(704)	31.000	13%	(1.453)	(185)	**(889)**	**24%**
UK	59.333	15%	(3.955)	(583)	38.000	16%	(1.453)	(227)	**(810)**	**28%**
France	55.429	14%	(3.955)	(544)	33.000	14%	(1.453)	(197)	**(741)**	**25%**
Italy	37.669	9%	(3.955)	(370)	30.000	12%	(1.453)	(179)	**(549)**	**31%**
Spain	35.706	9%	(3.955)	(350)	22.000	9%	(1.453)	(131)	**(482)**	**35%**
Poland	25.666	6%	(3.955)	(252)	14.000	6%	(1.453)	(84)	**(335)**	**75%**
Netherlands	16.144	4%	(3.955)	(159)	9.500	4%	(1.453)	(57)	**(215)**	**26%**
Romania	11.178	3%	(3.955)	(110)	8.100	3%	(1.453)	(48)	**(158)**	**98%**
Belgium	9.570	2%	(3.955)	(94)	6.500	3%	(1.453)	(39)	**(133)**	**26%**
Sweden	9.216	2%	(3.955)	(91)	5.600	2%	(1.453)	(33)	**(124)**	**22%**

* The total tax revenue loss for Google (2013-2015) is estimated according to method 2

** The total tax revenue loss for Facebook (2013-2015) is estimated according to method 2

Article 5

Permanent establishment in a Member State of a taxpayer who is resident for tax purposes in the Union

1. A taxpayer shall be considered to have a permanent establishment in a Member State other than the jurisdiction in which it is resident for tax purposes when it has a fixed place *or digital presence* in that other Member State through which it carries on its business, wholly or partly, including in particular:

(a) a place of management;

(b) a branch;

(c) an office;

(d) a factory;

(e) a workshop;

(f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources;

(g) a digital platform.

2bis. If a taxpayer resident in one jurisdiction provides access to or offers a digital platform such as an electronic application, database, online marketplace, storage room or offers search engine or advertising services on a website or in an electronic application, this taxpayer shall be deemed to have a permanent establishment in a Member State other than the jurisdiction in which it is resident for tax purposes if the total amount of revenue of the taxpayer due to remote transactions generated from aforementioned digital platforms in the non-resident jurisdiction exceeds €5 000 000 per year. Furthermore, to determine a significant and sustained digital presence, the Commission shall lay down technical standards for the following digital factors:

(a) the number of registered individual users per month that are domiciled in a Member State other than the jurisdiction in which it is resident for tax purposes who logged in or visited the taxpayer's digital platform;

(b) the number of digital contracts concluded with customers or users that are domiciled in the non-resident jurisdiction in a taxable year;

(c) the volume of digital content collected by the taxpayer in a taxable year.

If on top of the revenue-based factor, one or more of the three digital factors above as defined by the Commission are applicable for a taxpayer in the relevant Member State, the taxpayer shall be deemed to have a permanent establishment in that Member State.

Note: This amendment is based on the OECD/G20 Discussion Draft (2014) (section 3.2. and 3.3.)[4], the OECD/G20 Final Report (2015) (section 7.6.1.)[5] and Hongler & Pistone (2015)[6].

[4] https://www.oecd.org/ctp/tax-challenges-digital-economy-discussion-draft-march-2014.pdf (p. 65-66)
[5] http://www.oecd-ilibrary.org/docserver/download/2315281e.pdf?expires=1500021836&id=id&accname=guest&checksum=8C6F02952FB375C98A4C40CC536C147A (p. 107-111)
[6] https://www.ibfd.org/sites/ibfd.org/files/content/pdf/Redefining_the_PE_concept-whitepaper.pdf