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THE IMPACT OF AN EU DIGITAL SERVICE TAX ON GERMAN BUSINESSES

Report

ON BEHALF OF BUNDESVERBAND
E-COMMERCE UND VERSANDHANDEL DEUTSCHLAND E.V.
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PREFACE

On 21 March 2018, the European Commission proposed a Digital Services Tax (DST) as a new tax on revenues resulting from certain digital business activities. Specifically, a 3% tax on:

- Online advertising revenues
- Seller/buyer fees to transact via online intermediaries/marketplaces
- Revenues from the sale of user data

The Commission argues in its impact assessment (IA) that there will only be a limited impact at the macro-level of introducing the DST but provides little evidence to support this claim. Furthermore, the Commission argues for a relatively low pass-through rate (i.e. the ability of digital businesses to absorb or pass-on the tax increase to downstream customers or end-users) and provides very little evidence on the expected impact on European businesses (including SMEs).

On this background, the Bundesverband E-Commerce und Versandhandel Deutschland e.V. has asked Copenhagen Economics to analyse the impact of the DST on German businesses.

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ZUSAMMENFASSUNG

Am 21. März 2018 hat die Europäische Kommission die Einführung einer Digitalsteuer (Digital Service Tax – DST) als neue Steuer auf Einnahmen aus bestimmten digitalen Geschäftstätigkeiten vorgeschlagen. Insbesondere eine Steuer von 3 % auf:

- Online-Werbeeinnahmen
- Verkäufer- und Käufergebühren auf Online-Marktplätzen und Plattformen
- Einnahmen aus dem Verkauf von Nutzerdaten

Nach dem Vorschlag der Kommission soll nur ein Teil der Digitalunternehmen der DST unterliegen. Dies betrifft Unternehmen mit einem Gesamtumsatz von mehr als 750 Mio. € (weltweit) und einem digitalen Umsatz von mehr als 50 Mio. € (EU-weit). Dies könnte den Eindruck erwecken, dass nur multinationale Konzerne von der Steuer betroffen wären und deutschen Unternehmen weitgehend unberührt blieben.

In dieser Studie zeigen wir jedoch:

- Die Steuerlast der DST wird – bezogen auf die Dienstleistungen, die auf dem deutschen Markt erbracht werden – zumindest teilweise, wenn nicht gar vollständig, an deutsche Unternehmen und Verbraucher weitergegeben werden, zum Teil aufgrund niedriger Margen.
- Die DST ist eine verzerrende Steuer und zielt auf die digitale Infrastruktur ab, auf die deutsche Unternehmen (insbesondere kleine und mittlere Unternehmen – KMU) angewiesen sind, um mehr Kunden zu geringeren Kosten zu erreichen.
- Die anvisierten deutschen Märkte wachsen rasant und machen heute bereits einen bedeutenden Teil der deutschen Wirtschaft aus.

Die DST wird zu einem Großteil an deutsche Nutzer weitergegeben werden

Obwohl der DST-Vorschlag dahingehend, welche Unternehmen in den Anwendungsbereich der DST fallen, erhebliche Rechtsunsicherheit schafft, scheint die Steuer auf US-amerikanische multinationale Unternehmen ausgerichtet zu sein.

Allerdings dürften auch deutsche digitale Unternehmen in den Anwendungsbereich fallen. Während die multinationalen Unternehmen die Steuer einziehen und den Steuerbehörden der EU übergeben, werden sie höchstwahrscheinlich die Steuerlast an Unternehmen und Kunden, die Online-Marktplätze oder Online-Plattformen nutzen, weitergeben. Besonders langfristig erwarten wir, dass sich die Einführung der DST in einer entsprechenden Preiserhöhung widerspiegeln wird. Dies bedeutet, dass die Steuerlast nicht von multinationalen Unternehmen getragen wird, sondern von deutschen Unternehmen (insbesondere KMU), die auf die DST-pflichtigen Dienstleistungen angewiesen sind. Zusätzlich werden auch Verbraucher, die die DST-pflichtigen Dienste nutzen, betroffen sein.

Die DST ist eine verzerrende Steuer, die die Digitalisierung der deutschen Wirtschaft verlangsamen wird

Für die These, dass die DST eine mildernde Steuer ist, die eine Unterbesteuerung von Digitalunternehmen kompensiert, können wir keinen Nachweis finden. Gerade deutsche Digitalunternehmen müssen höhere effektive Unternehmenssteuersätze auf höheren Ebenen zahlen als traditionelle Firmen. Außerdem betonen wir, dass mit den jüngsten US-Steuerreformen das Einkommen von US-Unternehmen von EU-Märkten zu höheren effektiven Steuersätzen besteuert wird.

Anders ausgedrückt, die durch die DST hervorgerufenen höheren Preise werden marktverzerrende Auswirkungen auf die deutsche Wirtschaft haben. Sie verringern die Anreize für Unternehmen, die Dienstleistungsmodelle zu wählen, die die niedrigsten gesellschaftlichen Kosten haben und den kleineren Unternehmen einen besseren Marktzugang ermöglichen.

Somit wird die vorgeschlagene DST die Digitalisierung der deutschen Wirtschaft verzerren und damit verlangsamen. Außerdem befürchten wir, dass die DST diskriminierend wirkt auf:

- Die deutsche E-Commerce-Branche im Vergleich zu traditionellen Geschäftsmodellen
- Deutsche Unternehmen, die auf Online-Plattformen ihre Waren anbieten und hier auf gezielte Werbung zu geringen Kosten angewiesen sind
- Deutsche Marktplatznutzer (insbesondere KMU) im Vergleich zu anderen Online-Verkäufern
- Deutsche Exporteure, die auf Online-Marktplätze angewiesen sind, im Vergleich zu Nicht-EU-Wettbewerbern

Zusammenfassend kann also gesagt werden, dass Unternehmen, die Online-Marktplätze und -Plattformen nutzen, mit Geschäftsmodellen, die außerhalb des Anwendungsbereichs der DST liegen, konkurrieren werden. Somit werden Geschäftsmodelle gefördert, die nicht DST-pflichtig sind, was den Kern der Marktverzerrung ausmacht. Diese Dynamik wird dadurch verstärkt, dass viele digitale Aktivitäten und Geschäftsmodelle margenschwach sind (z. B. E-Commerce), aber auch in einer anfänglichen Anlaufphase (neue Konzepte und Aktivitäten) negative Margen aufweisen können.

Die DST wird einen wichtigen und wachsenden Teil der deutschen Wirtschaft beeinflussen

E-Commerce spielt im Einzelhandel eine immer wichtigere Rolle. Seit 2014 steigt der E-Commerce-Umsatz jährlich um mehr als 10 % und macht damit einen immer größeren Anteil am deutschen Einzelhandelsmarkt aus. Im Jahr 2017 betrug der E-Commerce-Umsatz 73 Mrd. € oder etwa 14 % des gesamten Einzelhandelsmarktes.

Die DST zielt auf digitale Dienste ab, die wichtige Infrastrukturen für deutsche Unternehmen, insbesondere KMU, darstellen, um einen wachsenden E-Commerce-Markt sowohl im In- als auch im Ausland zu bedienen. Dies sollte im deutschen Kontext vor folgendem Hintergrund betrachtet werden:

- *Deutsche Verbraucher kaufen zunehmend online ein*: Heute nutzen 87 % der deutschen Bürger mindestens einmal pro Woche das Internet, 2009 waren es nur 71 %. Der Anteil der deutschen

Bürger, die online einkaufen, stieg im selben Zeitraum von 56 % auf 75 %. Darüber hinaus bestellen etwa 76 % der Online-Käufer mindestens einmal im Monat online.

- *Online-Marktplätze helfen Einzelhändlern, ihr Geschäft online zu starten und in Bezug auf Kosten, Reichweite und Innovation mit größeren Unternehmen zu konkurrieren:* Deutsche Unternehmen, insbesondere KMU, nutzen Online-Marktplätze, aufgrund der geringeren Markteintrittsbarrieren. Beispielsweise gaben 70 % befragter deutscher Sportartikelhändler an, dass sie zuerst über Online-Marktplätze anstatt über einen eigenen Webshop verkauft haben. Als Grund wurden Einrichtungs- und laufende Kosten des Webshops genannt. Außerdem bieten Online-Marktplätze, insbesondere kleinen und mittelständischen Unternehmen, eine größere Reichweite und Zugang zu technologischen Innovationen wie mobile Apps.
- *Online-Marketing spielt für den Einzelhandel eine immer wichtigere Rolle:* Online-Marketing auf digitalen Plattformen hat klare Vorteile gegenüber herkömmlichen Kanälen. Es ermöglicht selbst kleineren und mittelständischen Unternehmen zielgerichtet und kostengünstig lokale, nationale und internationale Konsumenten zu erreichen. Die meisten deutschen Unternehmen sind in den sozialen Medien präsent – um Bekanntheit zu schaffen und für ihre Produkte zu werben. Die Social-Media-Werbeeinnahmen in Deutschland beliefen sich im Jahr 2016 auf 682 Mio. €; Tendenz steigend.

Abschließende Bemerkungen

Alle digitalen Geschäftsmodelle sind relativ neu und beruhen darauf mithilfe des Internets Hindernisse für nationale und internationale Transaktionen weiter abzubauen. Daher hat die Besteuerung insbesondere in diesem Bereich den unbeabsichtigten Effekt, dass Aktivitäten neuer sowie angepasster digitaler Geschäftsmodelle diskriminiert werden, die die bestehenden Unternehmen/Modelle übertreffen könnten.

Die Digitalisierung fördert die Produktivität und die Wohlfahrt Deutschlands. Die digitalen Geschäftsaktivitäten, die im DST-Vorschlag genannt werden, stehen im Mittelpunkt der digitalen Transformation und dienen der sektorenübergreifenden Produktivitätsförderung, sowohl in Deutschland als auch in der EU. Deutsche Unternehmen und Verbraucher, die digitale Lösungen nutzen, konnten bereits davon profitieren und werden mit steigendem Wettbewerb und der Verbreitung neuer Innovationen sich noch weiter entwickeln.

In dieser Studie finden wir Belege dafür, dass die vorgeschlagene DST die gesamte Wertschöpfungskette, die von digitalen Aktivitäten profitiert, beeinflussen wird. Dies wird sich letztlich auf deutsche Unternehmen und Verbraucher auswirken. Die nachteiligen Auswirkungen, die wir in dieser Studie identifizieren, bedeuten erhebliche Rückschläge für die digitale Agenda in Deutschland.

EXECUTIVE SUMMARY

On 21 March 2018, the European Commission proposed a Digital Services Tax (DST) as a new tax on revenues resulting from certain digital business activities. Specifically, a 3 % tax on:

- Online advertising revenues
- Seller/buyer fees to transact via online intermediaries/marketplaces
- Revenues from the sale of user data

In the Commission's preferred option, a carefully selected subset of digital firms should face the DST, specifically firms with more than €750 million in global revenue, and having above €50 million in EU digital revenue. This could leave the impression that only global MNEs would be affected by the tax and ultimately leaving (most) German businesses unaffected.

However, in this study we find that:

- The tax burden of the DST - related to services provided to the German market - will at least partly, if not fully, be passed through to German businesses and consumers partly due to low margins.
- The DST is a distorting tax on the digital infrastructure that German businesses (most notably SMEs) rely upon to reach more customers at lower costs.
- The targeted German markets are growing rapidly and today already make up a significant share of the German economy.

The DST will to a large extent be passed on to German users

While the DST *proposal* leaves significant legal uncertainty about what businesses are in the scope of the DST, it seems targeted at US-based MNEs.

However, several German digital businesses are likely within the scope. While the global MNEs are collecting the tax and handing it over to EU tax authorities, they will likely pass on the tax burden to businesses and customers using online intermediaries or online platforms. At least in the long-run, we would expect that the introduction of the DST will be mirrored in an equivalent price increase. This implies that not global MNEs but German businesses, of which many are SMEs depending on the DST-liable services, and consumers using the services are bearing the tax burden.

The DST is a distorting tax slowing down the digitalisation of the German economy

We find no support for the view that the DST is a mitigating tax to compensate for under-taxation of digital companies. That is certainly the case for German digital companies that pay higher effective corporate tax rates on higher levels than traditional firms. We also underline that with the recent US tax reforms, the income of US firms from EU markets will be taxed at higher effective tax rates.

In other words, the higher prices induced by the DST are truly distorting for the German economy, reducing the incentives to choose the delivery models that have the lowest costs to society and allowing smaller firms better access to markets.

As a result, the proposed DST will distort and thus slow the further digitalisation of the German economy. Specifically, we find that the DST discriminates:

- The German e-commerce industry compared to traditional business models
- German businesses relying on online platforms for targeted advertisement at low cost
- German marketplace users (notably SMEs) compared to non-intermediated online sellers
- German exporters relying on online marketplaces compared to non-EU competitors

In a nutshell, businesses using online marketplaces and platforms have competition from business models that are outside the scope of the DST. This inexorably promotes business models that are not subject to the DST – the essence of the distortion. These key dynamic is exacerbated for the many digital activities/business models that are (i) low-margin (e.g. e-commerce), but also more broadly (ii) based on initial ramp-up phases with negative margins (new concepts/ventures).

The DST will impact an important and growing part of the German economy

E-commerce is playing an increasing role in the retail sector. Since 2014, turnover from e-commerce has annually increased by more than 10%, making up a larger and larger share of the German retail market. In 2017, turnover from e-commerce was € 73 billion or approximately 14% of the total retail market.

The DST is aimed at digital services that are important infrastructures for German businesses, especially SMEs, to serve a growing e-commerce market domestically but also internationally. This should be seen in a German context, where it is important to emphasise that:

- *German consumers increasingly shop online:* Today, 87% of German citizen use the internet at least once a week, compared to just 71% in 2009. The share of German citizens that shop online rose from 56% to 75% in the same period. Moreover, approximately 76% of online shoppers order online at least once a month.
- *Online marketplaces aid retailers to start their business online and to compete with larger businesses in terms of cost, reach and innovation:* German businesses, especially SMEs, use online marketplaces to eliminate entry barriers, e.g. 70% of surveyed German sport goods retailers started using online marketplaces before creating their own website to minimise set-up and running cost. Also, online marketplaces provide, especially for SMEs, a wider reach and access to technological innovation such as mobile apps.
- *Online marketing plays an increasing role for retailers:* Online marketing on digital platforms has clear advantages by being more targeted than traditional channels. It gives even small and medium sized businesses cost-effective means to reach a local, national and international audience. Most German businesses are present on social media to create awareness and advertise their products. In 2016, social media advertising revenues in Germany amounted to € 682 million, with this figure predicted to increase in the future.

Concluding remarks

All digital business models are relatively new, relying on the lowering of barriers to interaction opened by the internet. Thus, particularly in this area, taxation has the unintended effect of distorting activities in new/adapted digital business models that could otherwise more easily outcompete existing firms/models.

Digitalisation is promoting German productivity and welfare. The digital business activities singled out in the DST proposal are at the heart of the digital transformation and unlocking of productivity across sectors of the German economy and the EU more broadly. German businesses and consumers embracing digital solutions have gained and are standing to gain further as competition and new innovations are tested and diffused.

In this study, we find evidence that the proposed DST will affect the entire value chain benefiting from digital activities – thus ultimately affecting German businesses and consumers. The identified distortive effects each risk substantial setbacks for the digital agenda in Germany.

CHAPTER 1

ONLINE MARKETPLACES AND PLATFORMS ARE IMPORTANT INFRASTRUCTURES FOR GERMAN BUSINESSES

In this chapter, we explain how German businesses increasingly rely on the services targeted by the DST, i.e. online marketplaces and platforms, to serve their customers. First, we show that consumers increasingly purchase goods and services online and how online marketplaces and platforms are integral parts of the channels that businesses use to reach many customers (Section 1.1). Next, we explain how online marketplaces and platforms aid businesses in the start-up phase and enable small and medium sized enterprises (SMEs)[1] to compete with larger businesses (Section 1.2). Then, we discuss the increasing role of online marketing via social media for German businesses (Section 1.3). Finally, we demonstrate how the businesses that are relying on online marketplaces and platforms matter for the German economy (Section 1.4).

We support our arguments by insights from interviews that we conducted with various German businesses that are using online marketplaces and platforms for e-commerce and online marketing.

1.1 GERMAN BUSINESSES DEPEND ON ONLINE MARKETPLACES AND PLATFORMS TO REACH THEIR CUSTOMERS

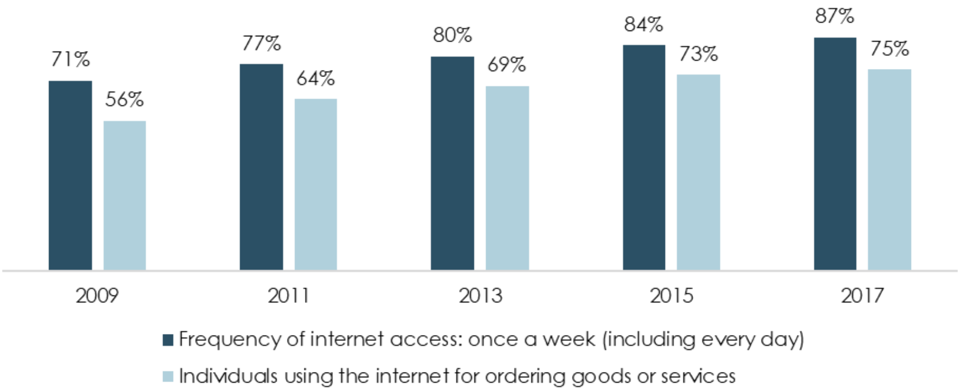
Businesses serve the need of their customers and usually offer their goods and services where the consumers are. With consumers' growing use of the internet comes an increasing propensity to shop online. It is thus crucial for businesses to have a digital strategy and to reach their customers online where they spend more and more of their time.

German consumers increasingly shop online

German consumers both access the internet more frequently and shop online more and more often. From 2009-2017, the share of German consumers that shop online has risen from 56% to 75%, see Figure 1. This is likely in part driven by the increased use of the internet, e.g. the share of German individuals that access the internet at least once per week has risen from 71% in 2009 to 87% in 2017.

[1] Small and medium sized enterprises (SMEs) are defined as enterprises with less than 250 employees; more specifically enterprises with 10-49 employees are categorised as small and with 50-249 employees as medium (enterprises with 1-9 employees as micro). Also, medium sized enterprises are usually businesses with less than € 50 million turnover, small with less than € 10 million turnover (and micro with less than € 2 million turnover) (European Commission, DG Growth, http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition_en).

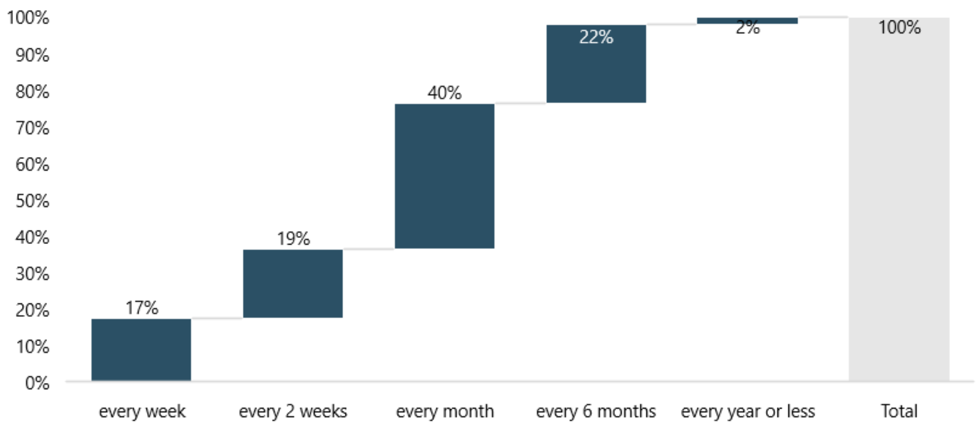
Figure 1
Share of individuals using the internet at least once per week and using it for ordering goods and services in Germany, 2009 – 2017
Per cent of individuals



Source: Copenhagen Economics based on Eurostat.

Consumers purchase goods and services online relatively frequently in Germany. In 2017, approximately 36% of online shoppers ordered goods online at least every 2 weeks and approximately 76% at least once a month, see Figure 2.

Figure 2
Frequency of ordering online in Germany, 2017
Per cent



Note: Based on a survey of German consumers.
Source: Copenhagen Economics based on bevh (2017) Interaktiver Handel in Deutschland B2C.

Online shopping also makes the purchases of goods from abroad easier. In 2017, almost 20% of Europeans used the internet to order goods and services from EU countries other than their home country compared to merely 8% in 2009[2].

Moreover, consumers' online shopping habits are changing, too. For example, mobile phones play an increasing role in the purchase of goods online. In 2017, almost 30% of online orders were done by mobile phones and tablets as opposed to stationary PCs or laptops, compared to only 20% in 2015[3]. Businesses need to adapt to those changes quickly but keeping up with the technological development and changing consumer behaviour can be very costly and thus especially burdensome for smaller businesses.

Online marketplaces and platforms are important channels for businesses to reach their customers

Online marketplaces minimise search costs and enable consumers to buy at any time and anywhere. Consumers shop using multiple retail channels and are generally more empowered than in the past when brick-and-mortar stores were the main shopping destinations.

Retailers can make use of a multitude of retail channels both online (e.g., various online marketplaces, online platforms, own online shops) and offline (e.g., physical shops, tele shopping, catalogue orders). Many businesses sell via various channels, see left panel in Figure 3. Many originally offline retailers are also e-tailers and offer their products and services increasingly online. Some pure online players now also sell via physical shops. While some businesses create their own online shops on their webpages, online marketplaces and platforms already provide existing online webpages, mobile apps, payment systems etc. Therefore, they constitute an important channel for selling products and services especially for SMEs that benefit from accessing an extensive customer base on new markets at small costs. Around 18% of surveyed businesses reported that keeping a stationary shop is only possible due to their activities on online marketplaces[4].

Furthermore, online platforms enable businesses to target online marketing much more efficiently, see right panel in Figure 3. While traditional marketing channels, such as print press or a specific website, can offer marketing to a broad audience, online platforms allow businesses to target their marketing to specific individuals at lower costs. This is especially important for small businesses with limited marketing budget, smaller product range and less brand awareness. Hence, while larger businesses can afford broader marketing efforts because there are potential positive spill-over effects to other products, this is likely not the case for smaller businesses that often appeal to a narrower set of customers.

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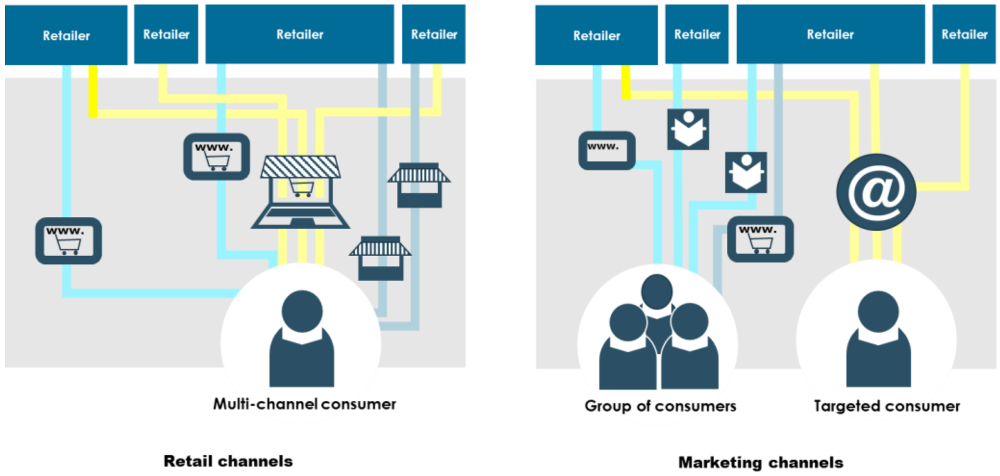
2 Eurostat, Individuals using the internet for ordering goods or services from other EU countries, https://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tin00003.

3 bevh (2016) Interaktiver Handel in Deutschland B2C, and bevh (2017) Interaktiver Handel in Deutschland B2C.

4 ECC (2018) Konjunkturumfrage unter Onlinemarktplatzhändlern, p.11https://www.ifhkoeln.de/fileadmin/registrierte_Downloads/Marktplatz-KIX/180612_ECC_eBay__Marktplatz-KIX_Fruehjahr_2018.pdf.

Figure 3
The German eco-systems



Source: Copenhagen Economics.

Box 1 Axel Niclas, COO – Celexon Group

"We rely on online marketplaces because this is where many consumers go to buy products. Consumers are increasingly using online marketplaces like Amazon equivalently to traditional shopping malls – consumers search for a specific product directly on Amazon and continue browsing for other products once they are there. From the consumers' perspective, online marketplaces always have everything available. We want to offer our products where the consumers buy them, and we invest – for example in IT know-how - to sell them in the best possible way on online marketplaces."

Source: Interview by Copenhagen Economics on 24/09/2018.

Box 2 Tim Kruse, CFA – Mercateo/Mercateo Unite

"Online platforms act as neutral infrastructure for suppliers and buyers and give them the digital means to trade freely – for example, they can set prices and other terms of conditions without any interference from the platform operator. Digital networks provide a level playing field for all participants irrespective of size. This is especially advantageous for SMEs who otherwise only have limited ability to compete with digital juggernauts. Therefore, online platforms enable digital connectivity at zero or the lowest possible cost in order to create strong network effects."

Source: Interview by Copenhagen Economics on 14/09/2018.

Box 3 Inken Gerick, Justiziarin (legal counsel) – Real.Digital

"Online marketplaces and platforms are important infrastructures for businesses to access new retail channels and thus to reach more customers. Different online marketplaces serve a different set of customers; thus, businesses use various online marketplaces to reach a variety of customers."

Source: Interview by Copenhagen Economics on 02/10/2018.

German producers that already have an online shop also use online marketplaces, often combined with physical stores. More than a third of them sell via Amazon's marketplace and a third via eBay's marketplace. Approximately 53% also sell offline via physical store in Germany, 21% via physical stores abroad and 16% via catalogues[5].

Retailers also market their products via various channels. Today, consumers can easily gather a wide array of information along every different type of retail channel before making a purchase by comparing prices and product characteristics and by learning from other consumers' experiences. Thus, in addition to traditional media such as newspapers, bulk mail, catalogues etc, retailers market products online on their own webpages and thereby reach groups of consumers. Also, price comparison webpages and search engines are used by consumers to inform their purchases.[6]

1.2 ONLINE MARKETPLACES AND PLATFORMS ENABLE SME RETAILERS TO START THEIR BUSINESS AND TO COMPETE WITH LARGER FIRMS

While most smaller businesses have competences in demand monitoring, product sourcing or customer service, they often lack an IT background to create their own webpages, apps, payment systems and other digital means to create an online presence.

Online marketplaces and platforms enable SMEs to create a broad online presence quickly and at low cost. In terms of cost, reach and innovation, online marketplaces provide tools to SMEs to compete with larger firms, that usually have more resources to create their own online stores.

Online marketplaces help SME retailers to start their business

Online marketplaces enable retailers to start their business by selling online. In a 2014 survey of German e-tailers with more than 90% being SMEs, three quarters reported that online marketplaces made online sales easier.[7] Around 70% of German sports goods retailers that eventually created their own online shop reported to have started out using online marketplaces to sell their goods, see Figure 4.

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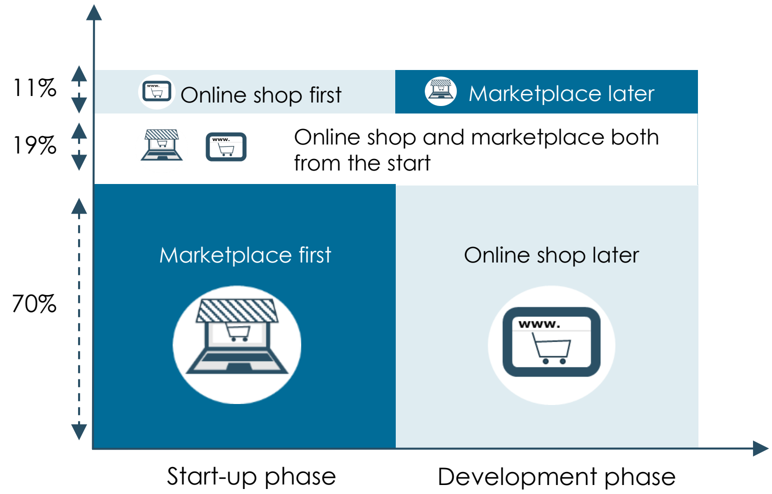
5 EHI Retail Institute and Statista (2017) E-commerce Markt Deutschland 2017, p. 48.
6 bevh (2017) Interaktiver Handel in Deutschland B2C.
7 Ecommerce Leitfaden, ibi research (2015) Online Marktplätze als Vertriebskanal, https://www.ecommerce-leitfaden.de/studien/item/online-marktplaetze-als-vertriebskanal, p. 48

Figure 4
Marketplaces or web shop – what comes first, 2013
Share of German sports goods retailers that eventually created their own online shop



Note: Based on a questionnaire of German sports good retailers that run their own web shop.
Source: Copenhagen Economics based on Sidley Austin (2013), p. 20.

Box 4 Axel Niclas, COO – Celexon Group

"Consumers trust big online marketplaces with respect to payment and return systems. That helps businesses to start selling online via online marketplaces."

Source: Interview by Copenhagen Economics on 24/09/2018.

Box 5 Jens Wasel, CEO – KW-Commerce

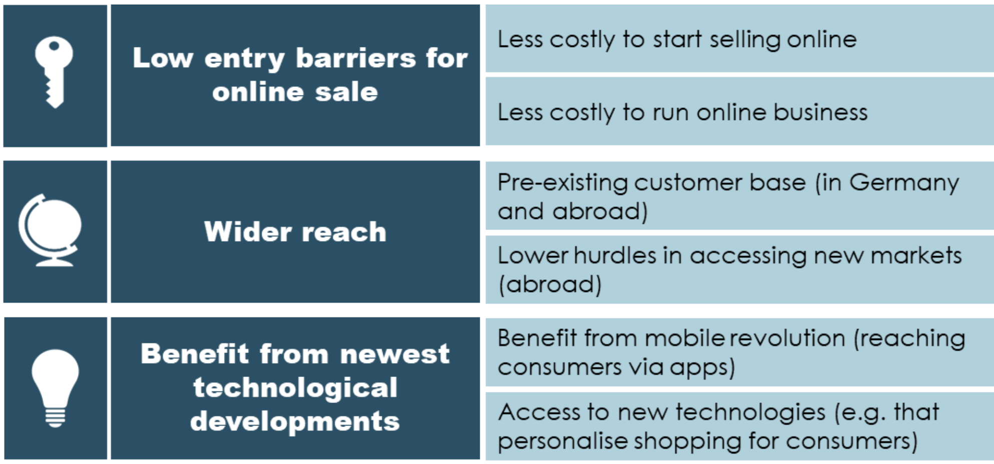
"Our business model evolves around using online marketplaces – large international and smaller local online marketplaces. In our start-up phase, selling via online marketplaces facilitated the process of acquiring customers and gaining brand recognition quickly. The advantage of online marketplaces is that we can sell our products without having to invest a lot of money and energy into online marketing. This allowed us to grow rapidly. The same holds for other start-ups and smaller companies."

Source: Interview by Copenhagen Economics on 17/09/2018.

Online marketplaces provide many opportunities for SMEs to stay competitive online in terms of cost, reach and innovation

SME retailers can benefit from online marketplaces as opposed to creating and selling via their own online shops because they i) offer low entry barriers towards online sales while ii) ensuring a wide reach including across borders and iii) facilitating SMEs to benefit from the newest technological developments, see Figure 5.[8]

Figure 5
Synergy between online marketplaces and e-tailers



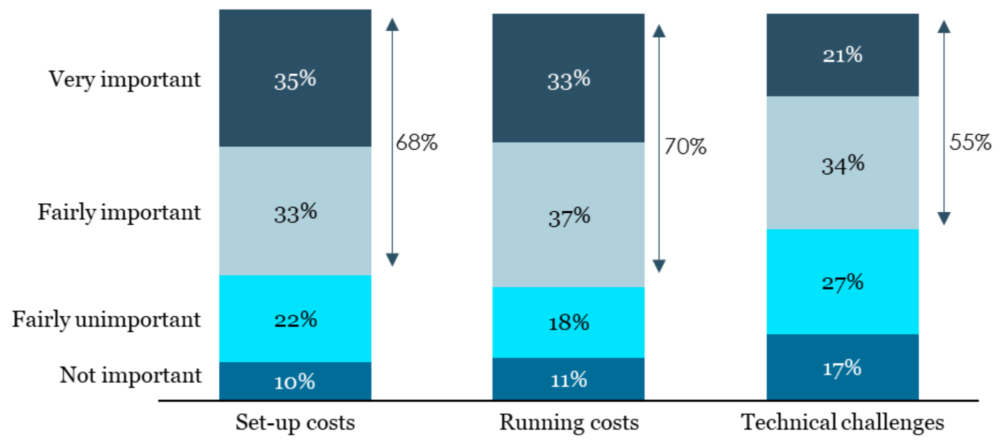
Source: Copenhagen Economics.

Low entry barriers towards online sales

Using online marketplaces comes at lower costs than creating your own website shops, e.g. 68% of German retailers reported in a 2013 survey that set-up costs are fairly to very important in their decision not to create their own online store. Equally, the running costs of own online stores is perceived as a hurdle to around 70% of surveyed German retailers, see Figure 6. Additionally, selling via online marketplaces is possible without the IT expertise required to set-up a well-functioning, high-quality online store.

[8] For a more thorough discussion, see Copenhagen Economics (2016) Economic effects of online marketplace bans.

Figure 6
Importance of costs for not opening an own online store in Germany, 2013
Share of retailers



Note: Sidley Austin survey of German retailers in 2013.
Source: Copenhagen Economics based on Sidley Austin (2013).

Box 6 Axel Niclas, COO – Celexon Group

"Starting a business by selling on an established online marketplace is helpful for start-ups. It does not require the creation of the necessary infrastructure that selling via an own online shop does. For example, online marketplaces offer solutions for the communication with the customer, logistics, payments and book keeping."

Source: Interview by Copenhagen Economics on 24/09/2018.

Box 7 Inken Gerick, Justiziarin (legal counsel) – Real.Digital

"Online marketplaces and platforms enable a wide reach quickly and at low expenses. Online marketplaces and platforms already have gained a positive reputation, cover advertisement and offer solutions for all necessary processes (e.g. ordering, payment etc). When creating an own online shop, businesses have to invest in the design and maintenance of the shop, development of all processes and especially advertisement to reach consumers."

Source: Interview by Copenhagen Economics on 02/10/2018.

Box 8 Peter Sell, Marketplace Manager – Karstadt

"Especially for smaller merchants with specialised products, online marketplaces and platforms offer a less expensive and simpler way of selling online. Building an own online shop can be expensive in terms of meeting the technological and procedural requirements and in terms of the necessary advertising expenses to reach many customers."

Source: Interview by Copenhagen Economics on 02/10/2018.

Wider reach including cross-border sales

Online marketplaces facilitate wider reach both domestically and internationally. Online marketplaces offer an extensive customer base from the very beginning and extensive marketing opportunities. For instance, over 80% German retailers regard online marketplaces important to achieve a wider reach for their products contributing to their business' success, according to a recent survey.[9]

Consumers are increasingly moving from rural to urban areas. However, businesses that are established in rural areas can continue serving their customers irrespective of their geographical location by means of online sales. Online marketplaces facilitate such online sales even for SMEs and at low costs.

Two thirds of German retailers that are active on online marketplaces use them to sell abroad, according to a recent survey.[10] Selling across borders is generally easier for larger retailers that have the means to establish stores abroad or use their own online shops. However, online marketplaces and platforms are infrastructures that allow also for the internationalisation of SME retailers by providing the following.

First, online marketplaces and platforms improve the geographical reach of retailers which are no longer dependent on the size of their home markets. In the same way that online marketplaces and platforms provide a pre-existing customer base in the home country, they also enable even the smallest retailers to reach many customers abroad. Also, for example, the offered multi-language service systems lower cultural boundaries and hurdles related to taxation or regulation can be minimised via the use of online marketplaces.

Second, online marketplaces and platforms help to close the trust and experience gap between retailers and consumers. Retailers get the opportunity to brand themselves across borders. For consumers, using a familiar online marketplace or platform creates trust, for example by mitigating concerns related to the safety of online payment systems or return policies, and thereby decreases the home bias. Furthermore, online marketplaces and platforms alleviate consumers' access to information, for instance, on the quality of a good.

Third, online marketplaces and platforms provide important infrastructures that ease the delivery logistics for the retailers. There are shipping aid programmes in place that help e-tailers to deliver

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9 ECC Köln (2016) Marktplatz KIX - Q4 2016, https://www.ifhkoeln.de/marktplatz-kix/.

10 ECC (2018) Konjunkturumfrage unter Onlinemarktplatzhändlern, https://www.ifhkoeln.de/fileadmin/registrierte_Downloads/Marktplatz-KIX/180612_ECC_eBay__Marktplatz-KIX_Fruehjahr_2018.pdf.

their product to customers. Furthermore, delivery costs are reduced by aggregating SME demand for delivery services.

Box 9 Inken Gerick, Justiziarin (legal counsel) – Real.Digital

"Online marketplaces make the access of new geographical markets simpler and enable wide reach even across borders. For example, online marketplaces offer sometimes also logistic solutions and relieve businesses by covering ancillary services."

Source: Interview by Copenhagen Economics on 02/10/2018.

Box 10 Jens Wasel, CEO – KW-Commerce

"Online marketplaces allow us to trade internationally. We can tap into new markets when online marketplaces expand into new regions, as it was, for example, the case with Amazon's push into Mexico and Australia. Online marketplaces facilitate international trade since they take care of organisational work such as logistics. For example, as part of the Pan-European Programme offered by Amazon, retailers only send their goods to one warehouse of Amazon from where the goods are distributed to other Amazon warehouses in the whole EU and soon afterwards to customers. A lot of barriers of trading internationally are removed for the retailers by the large online marketplaces."

Source: Interview by Copenhagen Economics on 17/09/2018.

Box 11 Peter Sell, Marketplace Manager – Karstadt

"We are planning to expand abroad and are relying on online marketplaces and platforms to do so. It is easier to explore new markets in other countries, both European and Non-European, via online marketplaces and platforms. They provide quick access to new markets, which can be tested before expanding further, while dealing with legal and tax rules."

Source: Interview by Copenhagen Economics on 02/10/2018.

Benefit from the newest technological developments

Online marketplaces allow SMEs to benefit from technological developments and innovations. One such technological development is consumers' increased use of mobile phones for online shopping. The share of online orders via mobile phones or tablets increased from 20% in 2015 to 30% in 2017.[11] Building apps is costly and needs know-how. Additionally, consumers only use a limited number of apps and less often download apps by smaller retailers. Hence, without online marketplaces SMEs would be hindered in benefiting from the mobile revolution. In a survey of German e-tailers in 2014

[11] bevh (2016) Interaktiver Handel in Deutschland B2C, and bevh (2017) Interaktiver Handel in Deutschland B2C.

(with more than 90% being SMEs), one third reported that they use online marketplaces to reach mobile online shoppers.[12]

Keeping up with the most recent technological developments matters for SMEs to reach customers in remote locations or abroad better, facilitated by online marketplaces. For example, in some areas, consumers rely more heavily on mobile internet connections than on fixed broadband. Those consumers are more likely to purchase goods and services via mobile apps.

Online marketplaces also provide SMEs with the opportunity to employ and benefit from new innovations. Among others, such innovations are aiming at creating a more personalised shopping experience (see e.g., Alexa Voice Service, ShopBot and Blackbird).

Online marketplaces also matter for B2B relationships
Business-to-business (B2B) relationships also benefit from online marketplaces. In 2014, German businesses with B2B online shops generated almost € 70 billion revenue and employed some 200,000 people in 2017. With over 90%, most of the German businesses with B2B online shops are SMEs.[13] The role of online marketplaces for B2B trade is likely to increase in the future.[14]

Changes in consumers' behaviour towards more online shopping also influences businesses and drives an increase in online procurement of goods.[15] Setting up an online shop is equally costly for businesses active in B2B trade and thus they can benefit similarly from selling via online marketplaces.

1.3 ONLINE MARKETING PLAYS AN INCREASING ROLE FOR RETAILERS

Since the role of online sales are growing, the business strategy for most firms is to expand their online presence. This does not only relate to retail channels but also means to broaden the use of various marketing channels.

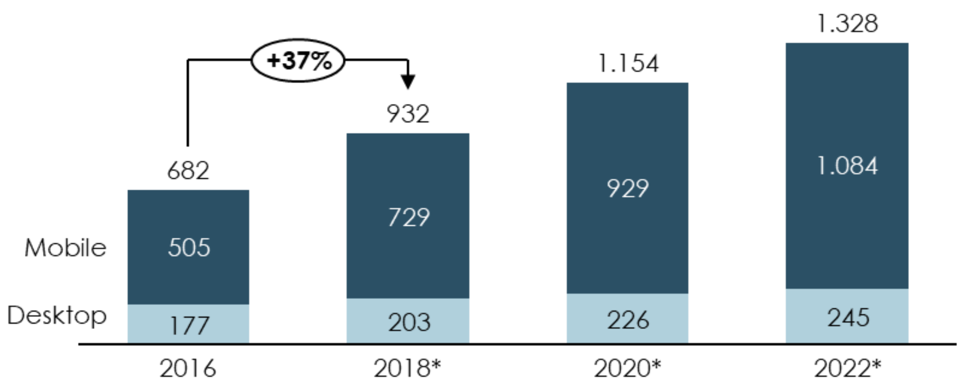
Digital advertising, for example through search engine ads and social media activities, gives businesses cost-effective means of reaching a local, regional, and international audience. Online marketplaces and platforms facilitate and strengthen marketing that is targeted to a specific consumer and thereby increases turnover.[16] Thus, especially for smaller businesses, online marketing holds many

[12] Ecommerce Leitfaden, ibi research (2015) Online Marktplätze als Vertriebskanal, https://www.ecommerce-leitfaden.de/studien/item/online-marktplaetze-als-vertriebskanal, p. 52.
[13] Creditreform (2017), B2B Online-Shops - Eine Vollerhebung der deutschen Wirtschaft im World Wide Web.
[14] ECC Köln (2017) B2B Marktplätze, https://www.ifhkoeln.de/b2b-marktplaetze/
[15] ECC Köln (2017) B2B Marktplätze, p.32, https://www.ifhkoeln.de/b2b-marktplaetze/
[16] Ecommerce Leitfaden, ibi research (2015) Online Marktplätze als Vertriebskanal, https://www.ecommerce-leitfaden.de/studien/item/online-marktplaetze-als-vertriebskanal, p. 48

opportunities and is a major source for export growth. In Germany, online advertising is estimated to amount to € 6.5 billion.[17]

Social media is one important channel for online advertising with a € 682 million revenue in 2016. Since consumers are increasingly online and use social media more intensely, businesses have more to gain. Forecasts by Statista predict that social media advertisement revenue will increase by 37% from 2016 to 2018 and will almost double by 2022, see Figure 7.

Figure 7
Social media advertisement turnover in Germany, 2016 with forecasts until 2022
Million EUR



Note: *Forecasts by Statista for the years 2018, 2020 and 2022.
Source: Copenhagen Economics based on Statista, Umsätze mit Social-Media-Werbung in Deutschland im Jahr 2016 sowie eine Prognose bis 2022 (in Millionen Euro), https://de.statista.com/statistik/daten/studie/456177/umfrage/umsaetze-mit-social-media-werbung-in-deutschland/

Via social media, businesses can share information and spread knowledge targeted at specific consumers. Online platforms facilitate and strengthen social media marketing[18], which allows businesses to influence customer's behaviour and to strengthen their market position. Businesses use social media for brand exposure and interaction with customers. For example, 86% of retailers active on social media report that they use it for branding and to introduce new products.[19] These platforms also help companies to increase the traffic on their online shops, for instance, by advertising with a direct button to the online shops.

[17] Wissenschaftlicher Beirat beim Bundesministerium der Finanzen (2018), Stellungnahme zu den EU-Vorschlägen für eine Besteuerung der digitalen Wirtschaft, p. 4, https://www.bundesfinanzministerium.de/Content/DE/Standardartikel/Ministerium/Geschaeftsbereich/Wissenschaftlicher_Beirat/Gutachten_und_Stellungnahmen/Ausgewaehlte_Texte/2018-09-27-digitale-Wirtschaft.html.

[18] Ecommerce Leitfaden, ibi research (2015) Online Marktplätze als Vertriebskanal, https://www.ecommerce-leitfaden.de/studien/item/online-marktplaetze-als-vertriebskanal, p. 48

[19] Destatis (2017) Unternehmen und Arbeitsstätten - Nutzung von Informations- und Kommunikationstechnologien, https://www.destatis.de/DE/Publikationen/Thematisch/UnternehmenHandwerk/Unternehmen/InformationstechnologieUnternehmen5529102177004.pdf?__blob=publicationFile, p. 30-31.

Box 12 Inken Gerick, Justiziarin (legal counsel) – Real.Digital

"Social media is an important online advertising channel for us, after search engines and price comparison webpages. We use, for example, Facebook and increasingly also influencers to disseminate new campaigns. Social media facilitates to reach new customer groups by targeting specific consumers, especially younger consumers. We are planning to increase social media advertisement even more in the future."

Source: Interview by Copenhagen Economics on 02/10/2018.

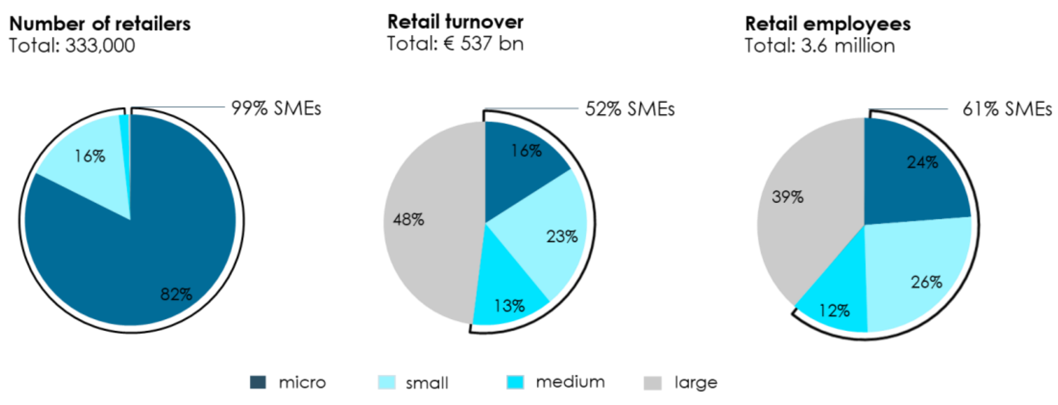
1.4 BUSINESSES RELYING ON ONLINE MARKETPLACES AND PLATFORMS MATTER FOR THE GERMAN ECONOMY

The businesses that rely on online marketplaces and platforms, and thus will be affected by the Digital Service Tax, contribute considerably to the German economy. SMEs play a vital role in the large German retail sector in which the turnover from e-commerce has been increasing in recent years. Online marketplaces and platforms contribute largely to the e-commerce revolution.

SMES are the backbone of the German retail sector

The retail sector plays an important role in the German economy and SMEs are the backbone of this sector. Some 3.6 million people are employed by retailers who account for almost € 540 billion in turnover. SMEs made up 99% of those retailers in 2016 and accounted for more than half of the turnover and more than 60% of the employment in the retail sector, see Figure 8.

Figure 8
SMEs in the German retail sector, 2016

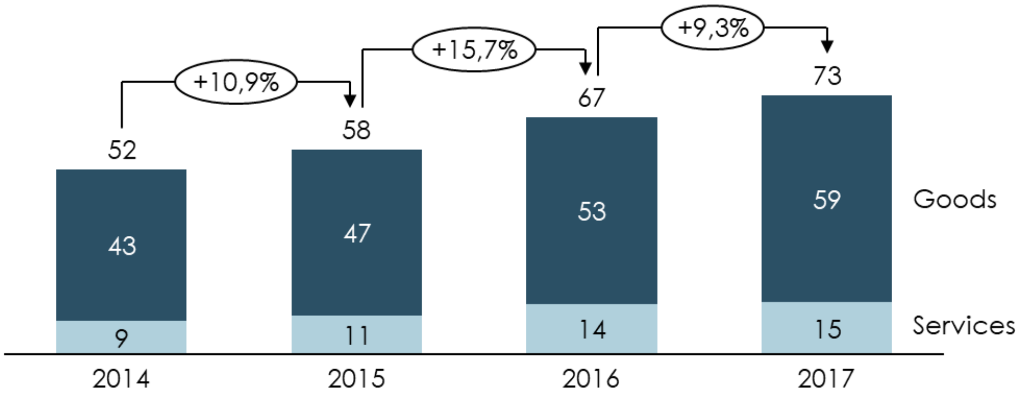


Source: Copenhagen Economics based on Eurostat.

Many German retailers increasingly rely on e-commerce

In 2016, more than 10% of the turnover in the retail sector in Germany was generated via e-commerce.[20] Since 2014, the turnover from e-commerce in Germany increased by 40% from €52 billion in 2014 to €73 billion in 2017, see Figure 9.

Figure 9
Turnover from (B2C) e-commerce in Germany, 2014 – 2017
Billion EUR



Source: Copenhagen Economics based on bevh (2017) Interaktiver Handel in Deutschland B2C.

The most recent data shows that the growth in e-commerce in Germany has continued in 2018. In the first nine months of 2018, the accumulated e-commerce turnover was with € 45 million in goods and € 13 million in services 11.3% higher compared to the same period in 2017.[21] The steady increase in the e-commerce turnover in Germany is expected to continue. A forecast by IFH Köln predicts a yearly growth rate of 9.1% until 2021.[22]

Sales via online marketplaces and platforms are substantial for German e-tailers

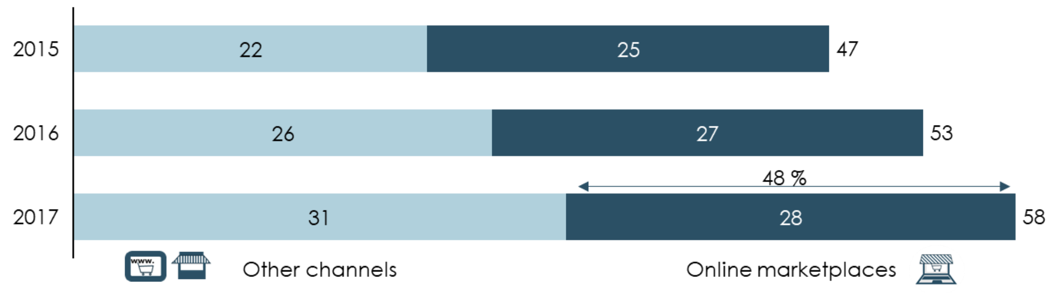
German e-tailers sell via various channels, online and offline. In 2017, online marketplaces accounted for almost half of the turnover (€28 billion) that German e-tailers achieved with the sale of goods. Thus, online marketplaces are a major e-commerce channel. The turnover generated via online marketplaces increased by around €3 billion since 2015, see Figure 10. Since businesses are currently expanding their online presence and e-commerce is growing, the turnover on online marketplaces will likely rise even further.

[20] Destatis, https://www.destatis.de/EN/FactsFigures/EconomicSectors/DomesticTradeAccommodationFoodServicesActivitiesTourism/RetailTrade/RetailTrade.html.

[21] Bevh (2018), Pressemitteilung 15.04.2018, Pressemitteilung 08.07.2018 and Pressemitteilung 09.10.2018, https://www.bevh.org/presse/pressemitteilungen/.

[22] IFH Köln (2017) Pressemitteilung 23.11.2017, https://www.ifhkoeln.de/pressemitteilungen/details/ifh-prognose-onlinehandel-in-deutschland-knackt-bis-2021-die-80-milliarden-euro-grenze/.

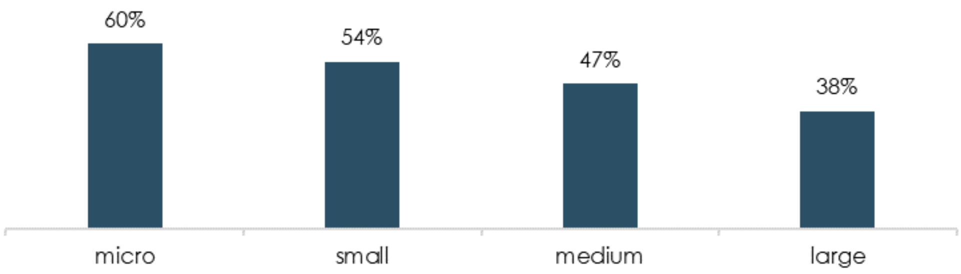
Figure 10
Turnover of goods in e-commerce by sender types in Germany, 2015 – 2017
Billion EUR



Note: Other channels include, among others, internet-pure players and multichannel senders (orders via catalogue, internet and phone).
Source: Copenhagen Economics based on bevh (2016) Interaktiver Handel in Deutschland B2C, and bevh (2017) Interaktiver Handel in Deutschland B2C.

Especially SMEs rely on online marketplaces to sell online. For larger enterprises, online marketplaces matter less as an online retail channel. In 2016, 60% of micro enterprises (with 1 - 9 employees), 54% of small enterprises (10 - 49 employees) and 47% of medium sized enterprises (50 – 249 employees) used online marketplaces to sell online, see Figure 11.

Figure 11
Share of businesses selling via online marketplaces by firm size in Germany, 2016
Per cent of businesses that sell online or via apps



Source: Copenhagen Economics based on Destatis (2017) Unternehmen und Arbeitsstätten - Nutzung von Informations- und Kommunikationstechnologien, p. 17.

In addition to business-to-consumer (B2C) relationships, online sales also matter for business-to-business (B2B) relationships. Online procurement of goods by businesses is likely to increase in the future and thereby also the use of online marketplaces for B2B transactions.[23]

[23] ECC Köln (2017) B2B Marktplätze, p.32, https://www.ifhkoeln.de/b2b-marktplaetze/

CHAPTER 2

A DIGITAL SERVICE TAX CREATES DISTORTIONS AND ECONOMIC DETRIMENT

The proposed EU Digital Services Tax (DST) is aimed precisely at the infrastructure used by German businesses in the critical start-up phase and later to promote growth and innovation. This chapter starts by explaining two basic facts about taxation: i) like any other tax, the DST is ultimately paid by individuals, ii) the tax will at least partly, if not fully, be passed down from platforms to German businesses, and ultimately to German consumers and investors (Section 2.1). Next, we argue that the DST suffers from design problems and creates distortions that are likely going to affect German SMEs disproportionately. This should be seen in a German context where digital businesses are already taxed at higher rates than traditional businesses (Section 2.2). All in all, the proposed EU DST will hamper Germany's digital transformation and hurt businesses relying on digital platforms liable for the DST.

2.1 A DST WILL BE PASSED ON TO BUSINESSES RELYING ON ONLINE MARKETPLACES AND PLATFORMS TO PROMOTE GROWTH AND INNOVATION

On 21 March 2018, the European Commission proposed a Digital Services Tax (DST) as a new tax on revenues resulting from certain digital business activities. Specifically, a 3% tax on:

1. Online advertising revenues,
2. Seller/buyer fees to transact via online intermediaries/marketplaces
3. Revenues from the sale of user data.

In the Commission's preferred option, a carefully selected subset of digital firms should face the additional tax of 3%, specifically firms with more than €750 million in global revenue, and having above €50 million in EU digital revenue.[24] The DST-liable firms are responsible for collecting the tax.

This could leave the impression that only global MNEs would be affected by the tax and ultimately leaving (most) German businesses unaffected. However, the DST – as any other tax – is ultimately paid by individuals, not global MNEs, and the tax burden will either end up at the investors or the consumers.

Generally, the tax burden of the DST mainly falls on either:[25]

- Investors in MNEs targeted for the DST

[24] Without going into any detail such, such choice of seem arbitrary, as discussed in See Copenhagen Economics (2018) The proposed EU Digital Services Tax: Effects on welfare, growth and revenues. Furthermore, ring-fencing the digital economy for taxation purposes is infeasible, as the digital economy is increasingly becoming the economy itself, see OECD (2015) Addressing the Tax Challenges of the Digital Economy, Action 1 - Final Report.

[25] Other stakeholders could in principle also be bearing part of the tax burden, e.g. employees that receive lower wages.

- Investors in down-stream German businesses using the services of DST-liable MNEs[26]
- German consumers

Firstly, it is important to remember that investors in MNEs can very well be German – either as shareholders or via implicit ownership through savings accounts (e.g. pension funds) – and investors are of course also consumers. Secondly, part of the tax burden is passed through to businesses using the digital platforms for advertisement or intermediation implying that either the investors in the German business bears the tax burden or the burden is again passed through to end-consumers.[27]

Introducing the DST is generally expected to be followed by equivalent adjustments in prices for the relevant services in the long-run, i.e. a full pass-through from platforms to businesses which is eventually expected to be passed on to consumers.[28] The full pass-through can either be driven by competition or low margins. Stated a little crudely, digital businesses that absorb the tax would run a long-run deficit as competition erodes excess profits.

In the Impact Assessment (IA) accompanying the proposal for the DST[29], the Commission references pass-through rates of approximately 33-50%[30] with reference to studies on VAT. However, we do not believe that such pass-through rates are in line with the empirical literature:

- The studies are based on expert assessments or a very short period of time[31]
- This ignores that increased rates are passed on to a larger extent than decreases[32]
- This ignores large heterogeneity across VAT changes[33]

Furthermore, many studies suggest significantly higher pass-through rates[34], while some studies even suggest so-called over-shifting, i.e. that prices will increase more than the monetary value of the tax.[35]

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26 This study focusses on the share of the DST related to the German market. More generally, the same arguments hold for other Member States.

27 This example is simplistic as B2B levels are ignored. However, the key conclusions are unaffected.

28 See e.g. Copenhagen Economics (2007) Study on reduced VAT applied to goods and services in the Member States of the European Union for the case of VAT.

29 European Commission (2018) Impact Assessment accompanying the documents: “Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence” and “Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services”, SWD(2018) 81 final/2. (IA henceforth)

30 AI page 75, with reference to European Commission (2012) – Economic Study on Publications on all Physical Means of Support and Electronic Publications in the context of VAT, p. 98 and Benedek et al. (2015) Estimating VAT Pass Through, p.16.

31 Benedek et al. (2015) Estimating VAT Pass Through, investigates a period starting one year before the tax is implemented and ending one year after. European Commission (2012) – Economic Study on Publications on all Physical Means of Support and Electronic Publications in the context of VAT, states: “We have gathered similar qualitative indications from stakeholder’s interviews and case studies. Given the structure of the industry we do not think it is credible to assume a full pass-on in prices. We have therefore decided to use a 50% pass-on rate, but because of the imprecision of this estimate the analysis is also conducted for a 100% pass-on rate to see the sensitivity of the results to such an assumption.”

32 See e.g. European Commission (2010) A retrospective evaluation of elements of the EU VAT system, p. 287.

33 E.g. Benedek et al. (2015) Estimating VAT Pass Through, finds full pass through for standard rate changes.

34 See Copenhagen Economics (2007) Study on reduced VAT applied to goods and services in the Member States of the European Union, Deutsche Bundesbank (2008) Price and Volume Effects of VAT increase on 1 January 2007, Jonker et al. (2004) An Empirical Analysis of Price Setting Behaviour in the Netherlands in the Period 1998-2003 using Micro Data, Kesselman (2011) Commentary/Commentaire – Consumer Impacts of BC’s Harmonized Sales Tax: Tax Grab or Pass-through?, Chirakijja et al. (2009) The Stimulus Effect of the 2008 UK Temporary Vat Cut

35 See Poterba (1996) Retail Price Reactions to Changes in State and Local Sales Taxes and Besley and Rosen (1999) Sales Taxes and Prices: An Empirical Analysis

In essence, we do not be believe that any empirical studies have presented convincing evidence for less than full pass-through in the long-run.

The pass-through rate is also driven up by low margins for digital businesses.[36] Businesses with low margins have no other choice than to pass-through the DST, as they would otherwise run a deficit or risk going out of this business. Similar concerns were also voiced in the interviews, see Box 13 - 16.

Ultimately, this suggests that an EU DST on digital MNEs would at least partly, if not fully, be passed down from platforms to German businesses, and ultimately to German consumers and investors. This will have obvious adverse effects on German businesses relying on these services. In the next section, we discuss impact on businesses in more detail focusing on the distortions arising from the DST.

Box 13 Axel Niclas, COO – Celexon Group

"It is likely that online marketplaces pass on the tax to the retailers because they have small margins. Whether retailers will absorb it in their margins or pass-on the extra cost further down to consumers is hard to predict."

Source: Interview by Copenhagen Economics on 24/09/2018.

Box 14 Peter Sell, Marketplace Manager – Karstadt

"Especially small companies and consumers will suffer from the DST as it is very likely that the tax will be passed on to them. Pass-on is probable due to the low margins in the industry (as especially cheap products are sold online, and due to the logistic and transport cost related to online sales)."

Source: Interview by Copenhagen Economics on 02/10/2018.

Box 15 Inken Gerick, Justiziarin (legal counsel) – Real.Digital

"The DST is an additional burden for businesses and providers of online marketplaces. A pass-on of such a tax from the online marketplaces to the businesses, and eventually from businesses to consumers, is very likely. If the cost of offering the infrastructure of an online marketplace increases, the price of using it will increase, too. Especially smaller marketplaces and businesses have less ability to absorb the tax because of their low margins."

Source: Interview by Copenhagen Economics on 02/10/2018.

[36] According to the Commission, a mark-up of 15% is the median for a selection of companies with digital activities, see IA p. 71. This should be compared with the IA saying that the DST is equal to a CIT rate of 20 percent.

Box 16 Jens Wasel, CEO – KW-Commerce

"The introduction of the DST would likely lead to higher commission rates on online marketplaces, making online retailers pay more to use online marketplaces. This, in turn, would lead to a pass-on of costs to consumers in form of higher prices set by online retailers. The DST is likely to hit the most consumers and small retailers that do not adjust their prices fast enough. The DST would be inefficient and unfair since the 3% tax is raised on gross revenues, which are vastly different for the different online retailers."

Source: Interview by Copenhagen Economics on 17/09/2018.

2.2 DISTORTIONS CREATED BY THE DST

The proposed DST will distort and thus slow the further digitalisation of the German economy. Specifically, we find that the DST discriminates:

1. The e-commerce industry compared to traditional business models
2. Business relying on online platforms for targeted advertisement at low cost
3. Marketplace users (notably SMEs) compared to non-intermediated online sellers
4. German exporters relying on online marketplaces compared to non-EU competitors

Such distortions should be seen in the light that tax burdens vary across sectors. The effective tax rate depends upon the extent to which firms can utilise R&D incentives and so-called IP boxes (a preferential tax regime for intellectual property used in some member states, but not in Germany). The benefits of this are naturally important for R&D intensive industries, such as digital and pharma. However, on the other hand R&D intensive firms rely more heavily on equity and have higher expected returns, which tends to increase the effective tax rate, as equity is taxed at a higher rate than debt in most member states (the so-called debt bias).

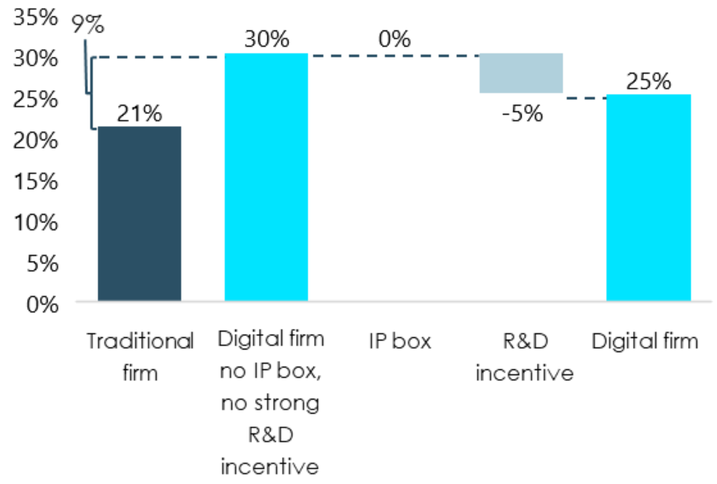
In fact, digital businesses in Germany are today taxed at higher Effective Average Tax Rates (EATR) than traditional businesses accounting for differences in finance structures and expected return.[37] In Germany, a digital company faces a higher theoretical effective tax rate of 25% against 21% for a traditional company, see Figure 12. In the absence of accelerated R&D depreciation allowances it would have been 30%.

Any additional tax on digital businesses, such as the DST, therefore risks creating an unlevel playing field between digital and traditional players in Germany. Recall that, according to the Commission, a 3% DST is equivalent to a 20% Corporate Income Tax (CIT) rate increase for a median digital business (with a mark-up of 15%).[38] Hence, the DST could have a detrimental impact on digital businesses in close competition with traditional players that are not DST-liable.

[37] See Copenhagen Economics (2018) The proposed EU Digital Services Tax: Effects on welfare, growth and revenues for a full review, p. 6.

[38] See IA, p. 71. Note, if the DST is deductible as a cost the effective rate is still significant but lower.

Figure 12
Effective average tax rates for digital and traditional businesses in Germany, 2017
Statutory CIT rate 30%



Source: Copenhagen Economics based on the Griffith / Devereux methodology and ZEW / PwC (2017) Steuerliche Standortattraktivität digitaler Geschäftsmodelle.

This should arguably also be seen in a German context where digital businesses already, according to a recent study, have the highest Effective Average Tax Rates (EATR) in the EU, see Figure 13.[39] The low theoretical effective average tax rates for digital firms observed in other EU member states are of course driven by R&D tax incentives and IP boxes in some member states, as mentioned above.

However, R&D tax incentives have been put in place for a reason, i.e. to align private and social objectives in a context of large perceived positive spill-overs from private R&D. Hence, effective tax rates may be lower for digital businesses because member states want to favour R&D and innovation.

Furthermore, in the absence of specific incentives, the debt bias punishes digital companies (and R&D-heavy industries like pharma and possibly telco) and if member states are concerned about too aggressive R&D incentives, they should modify these.

In any case it makes no sense, that the German government should introduce a DST to compensate for incentive schemes that favour R&D introduced in other member states.

[39] See ZEW / PwC (2017) Steuerliche Standortattraktivität digitaler Geschäftsmodelle, p. 13. This incidentally is also the study referenced by the Commission in the IA.

Figure 13
Effective average tax rates for digital businesses in Europe, 2017
Per cent

Source: ZEW / PwC (2017) Steuerliche Standortattraktivität digitaler Geschäftsmodelle, p. 13.

Generally, the DST is discriminating as there is no substantial evidence to suggest that online marketplaces or digital businesses more broadly are undertaxed[40] - especially not in a German context as argued above - and hence that there is a need for a correction/equalisation tax (the DST). Stated differently, no one is arguing that there is overconsumption of the digital service provided by the online marketplaces or platforms.

Furthermore, the many distortions created by the DST and the additional administrative burden for both the tax authority and the businesses need to be evaluated against the negligible tax revenues that it will generate.[41]

Additionally, there are several legal concerns related to the DST. Firstly, there is a potential risk of double taxation when a business is taxed in a country where it provides a service while the country in which it is established already collects taxes.[42] Secondly, the DST goes against the current paradigms in international corporate taxation by applying to gross revenues and by being raised in the country of service provision and not business establishment.[43] Thirdly, the DST's hybrid nature between a direct and an indirect tax creates legal uncertainty and risk.[44]

[40] See Copenhagen Economics (2018) The proposed EU Digital Services Tax: Effects on welfare, growth and revenues for a full review.

[41] Wissenschaftlicher Beirat beim Bundesministerium der Finanzen (2018), Stellungnahme zu den EU-Vorschlägen für eine Besteuerung der digitalen Wirtschaft, p. 4.

[42] Wissenschaftlicher Beirat beim Bundesministerium der Finanzen (2018), Stellungnahme zu den EU-Vorschlägen für eine Besteuerung der digitalen Wirtschaft, p. 2

[43] Wissenschaftlicher Beirat beim Bundesministerium der Finanzen (2018), Stellungnahme zu den EU-Vorschlägen für eine Besteuerung der digitalen Wirtschaft, p.4

[44] Wissenschaftlicher Beirat beim Bundesministerium der Finanzen (2018), Stellungnahme zu den EU-Vorschlägen für eine Besteuerung der digitalen Wirtschaft, p. 3

The DST discriminates the e-commerce industry compared to traditional business models
The DST is targeted at the infrastructures used by the e-commerce industry, while leaving the traditional business models, e.g. brick-and-mortar stores, unaffected. As at least part of the tax burden is passed on to German e-commerce businesses, they will either have to increase prices and lose market shares to businesses outside the scope of the DST or cut margins if possible.[45]

The DST discriminates businesses relying on online platforms for targeted advertisement at low cost
The DST targets online platforms "making available advertisement space" to German businesses. However, traditional advertisement, e.g. the print press, is left outside the scope. Especially for German SMEs, this will limit capital and cash flow and therefore limit funds to advertise. This can potentially be crippling, as the DST puts an extra burden on companies that can only afford targeted advertisement via digital platforms. Hence, the DST de facto favours businesses that can afford more traditional advertisement campaigns with broader scope.

The DST discriminates marketplace users (notably SMEs) compared non-intermediated online sellers/marketplaces
The DST would also impact mixed business models, i.e. firms that are both selling own products via a website and making the platform available for third-party sellers. In this case, the sales of own products via the website would be outside the scope of the DST (they would not qualify as taxable revenues), while sales by third parties would be covered by the DST.

This will distort the competition between own products and sales of third-party products, thereby bringing a disadvantage to marketplace users which in a German context are often SMEs, as argued above. This could generate an insourcing bias for the platform by giving them a counterproductive incentive to insource some of the products currently sold by third-party sellers.[46]

The DST discriminates German exporters relying on online marketplaces compared to non-EU competitors
The DST also discriminates German exporters using online platforms to export goods and services to non-EU buyers, compared to a non-EU competitor selling similar goods and services to the same non-EU buyers using the same online platform. Here, the non-EU competitor does not face any additional tax while the German business face the tax burden passed down from the digital platforms.

As argued above, this distortion will also hit SMEs disproportionately as online marketplaces facilitate exports by even the smallest retailers. Online marketplaces and digital advertising reduce trade costs for SMEs while at the same time providing them with a global presence and reach previously reserved to large (multinational) retailers. This enables SME retailers to benefit in the same way from internationalisation (larger market, larger customer pool, less dependent on domestic economy) as larger exporting retailers. However, the introduction of the DST would put German exporters at a competitive disadvantage potentially disrupting German SMEs from reaping the full benefits of online marketplaces.

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45 This key dynamic is exacerbated for the many digital activities / business models that are low-margin (e.g. retail).

46 As argued in a recent study, this appears to conflict with the European Commission's platform to business proposal which seeks to safeguard a level playing field between platforms and the SMEs using them, see European Commission (2018) Proposal for a Regulation on promoting fairness and transparency for business users of online intermediation services, COM(2018) 238 fin.

Concluding remarks

The DST seems counterproductive in the context of global tax policy efforts. The proposal for a DST should be seen in the context of recent advances in international corporate taxation, most noticeably the efforts made by the OECD in Base Erosion and Profit Shifting (BEPS) actions, the US tax reform and the EU Anti-Tax Avoidance Directive (ATAD). These policies and actions will arguably limit the historical scope of artificial profit shifting, better aligning the Corporate Income Tax (CIT) payments with the location of value creation. However, the actual impact is yet to be analysed in detail.

While the US tax reform adopted in 2017 is not directly linked to proposals for taxing the digital services in Germany, we find that some of the arguments for advancing the DST would be mitigated by the US tax reform, as, for many decades, US companies have had incentives to place retained earnings in low tax jurisdictions, due to a combination of:

- High statutory US corporate tax rate
- Weak Controlled Foreign Corporation (CFC) rules
- No US taxation of foreign profits until repatriated to the US

Depending on the tax compliance design by each MNE, before the US tax reform this could lead to lower final taxation of corporate income, as retained earnings, in principle, might never be formally repatriated. The new US reform, based on a much lower statutory rate, the introduction of CFC-like elements and US taxation on foreign profits on an accrual (not repatriation) basis will all logically limit these incentives.[47]

The DST also risks creating costly tax trade wars, if important trade partners decide to retaliate and raise a similar tax on German (and European) gross revenues.[48] Furthermore, the distinction between digital services and non-digital services can be difficult resulting in the tax being applied to both. Thus, the retaliation could even go further and be extended to German industrial products sold abroad with detrimental effects for the German industrial sector.[49]

47 See e.g. ZEW (2018) Analysis of US Corporate Tax Reform Proposals and their Effects for Europe and Germany, which provide an overview of the effects of the US tax reform adopted in December 2017.

48 While the DST is not explicitly discriminatory towards third country MNEs, some experts have highlighted it might de facto discriminate US based MNEs. Hufbauer and Lu (2018) The European Union’s Proposed Digital Services Tax: A De Facto Tariff, suggests that the European DST is “De Facto Discrimination” and that retaliation is not unlikely, see page 8 and 10.

49 Wissenschaftlicher Beirat beim Bundesministerium der Finanzen (2018), Stellungnahme zu den EU-Vorschlägen für eine Besteuerung der digitalen Wirtschaft, p. 5.

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