The Digital Consumption Tax

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Amid rising tension between the United States and France over the Digital Services Tax (DST), this article propositions the imposition of a Digital Consumption Tax, rather than the gross-receipts DST. The Digital Consumption Tax is not a new tax. It is a consumption tax (i.e. Value-Added Tax, or VAT, in Europe and sales tax in the United States) that is imposed on digital transactions. Such consumption tax would be applied on the seemingly free interaction between Facebook (and other companies alike) and its Users. This interaction, under which Users gain access to the Facebook platform for ‘free’ – should be treated as a barter exchange, where Users pay a deemed monthly subscription fee for the right to access the platform, and Facebook pays a deemed royalty-like payment to Users for the right to use data collected on them by such platform, and for the right to show targeted advisements on the platform. The main proposition of this article is that these deemed payments – the deemed subscription fee and the deemed royalty-like fee – are equal and offset each other, resulting in the current ‘free’ interactions that are taking place in the market. The immediate implications is that general principles of consumption tax that apply to barter exchanges should result in a ‘new’, uncollected, tax liability to Facebook, because the deemed subscription fee (as received by Facebook) should be subject to consumption tax (VAT or sales tax) in the country or state where service is consumed – that is where the individual User resides.

**Keywords:** Consumption Tax, Value-Added Tax, Digital Service Tax, Facebook, France, United States, Sales Tax

**INTRODUCTION**

Amid rising tension between the United States and France over the Digital Services Tax (DST), this article propositions the imposition of a Digital Consumption Tax, rather than the gross-receipts DST. The Digital Consumption Tax is not a new tax. It is a consumption tax (i.e. Value-Added Tax, or VAT, in Europe and sales tax in the United States) that is imposed on digital transactions. The Digital Consumption Tax would be applied on the seemingly free interaction between Facebook (and other companies alike) and on its Users. This interaction, under which Users gain access to the Facebook platform for ‘free’ – should be treated as a barter exchange, where Users pay a deemed monthly subscription fee for the right to access the platform, and Facebook pays a deemed royalty-like payment to Users for the right to use data collected on them by such platform, and for the right to show targeted advisements on the platform.

The main proposition of this article is that these deemed payments – the deemed subscription fee and the deemed royalty-like fee – are equal and offset each other, resulting in the current ‘free’ interactions that are taking place. The immediate implications of this proposition, is that general principles of consumption tax that apply to barter exchanges should result in a ‘new’, uncollected, tax liability to Facebook, because the deemed subscription fee (as received by Facebook) should be subject to Digital Consumption Tax in the country where service is consumed – that is where the individual User resides.

In Europe, and in France particularly, the additional revenue from the collection of VAT on the deemed subscription fee has two potential advantages. First, the additional revenue should allow France to rescind and repeal the controversial DST, easing the escalating tensions with the United States, while protecting its tax jurisdiction and its tax base. Second, France would have a stronger case against any potential repercussions taken by the United States amid the imposition of VAT, because (1) the VAT is clearly not a designated tax against US companies, as some suggest the DST was, and (2) all states in the United States should, and hopefully will, also exercise their taxing rights under their local sales tax such that the barter exchange treatment would apply uniformly, both within and without the United States.

**Notes**

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2 The ‘Google, Amazon, Facebook, Apple (GAFAT) Tax’ and the US Tariff

On 24 July 2019, France President Emmanuel Macron signed into law a controversial new set of rules that place, retroactively in effect from 1 January 2019, a 3% tax on companies that generate more than EUR 750 million in global digital sales and more than EUR 25 million of digital sales in France. The tax – DST – is imposed on gross revenue from digital services generated in France. Due to the relatively high kick in threshold (more than EUR 750 million in global digital sales and, out of which EUR 25 million in France alone), the DST is aimed mainly at large multinationals that provide digital services to consumers or users in France, and covers services ranging from providing a platform for selling goods and services online (i.e. Amazon and Apple) to targeted advertising based on user data (i.e. Facebook and Google). It was estimated that the DST would affect roughly thirty companies, most of which are American based.

The DST encountered heated resistance from its inception. US officials have claimed that its main purpose is to harm US digital companies and threatened to impose retaliatory tariffs on French products. President Trump ordered the US Trade Representative, Robert E. Lighthizer, to investigate the potential effects of the DST on US tech companies, and more specifically whether the French legislation ‘is discriminatory or unreasonable and burdens or restricts United States commerce.’

Consequently, on 10 July 2019, Lighthizer initiated an investigation of the French DST pursuant to section 302(b)(1)(A) of the Trade Act of 1974, as amended (the Trade Act). The Trade Act provides three types of acts, policies, or practices of a foreign country that can result in retaliatory actions: (1) trade agreement violations; (2) acts, policies or practices that are unjustifiable (defined as those that are inconsistent with US international legal rights) and burden or restrict US commerce; and (3) acts, policies or practices that are unreasonable or discriminatory and burden or restrict US commerce. If the US Trade Representative determines that an act, policy, or practice of a foreign country falls within one (or more) of these criteria, he must determine what action, if any, to take. When a certain act, policy or practice is deemed to be unreasonable or discriminatory and burdens or restricts US commerce, retaliatory actions include imposing duties, fees, or other import restrictions on the goods or services of the foreign country.

The investigation focused on whether the DST discriminated against US companies or was unreasonable as a tax policy (due its application on gross, rather than net, revenues and its retroactivity and its extraterritoriality), and whether its main purpose was to penalize US technology companies. On 2 December 2019, the US Trade Representative released its conclusions in a report, finding that (1) the DST is intended to, and by its structure and operation, does, discriminate against US digital companies, (2) the DST’s retroactive application is unusual and inconsistent with prevailing tax principles and renders the tax particularly burdensome for covered US companies, which will also affect their customers, including US small businesses and consumers, (3) the DST’s application to gross revenue rather than income contravenes prevailing tax principles and imposes significant additional burdens on covered US companies, (4) the DST’s application to revenues unconnected to a presence in France contravenes prevailing international tax principles and is particularly burdensome for covered US companies, and (5) the DST’s application to a small group of digital companies contravenes international tax principles counselling against targeting the digital economy for special, unfavourable tax treatment.

The report concluded that a range of tools may be appropriate to address these matters, including intensive bilateral engagement, WTO dispute settlement, or even ‘imposing duties, fees, or other import restrictions on the goods or services of [France].’ The recommendations were based on the finding that the DST is a discriminatory tax against US digital companies and that it violates international tax policy since it is imposed on the gross, rather than net, income (and as such imposes ‘unusually burdensome’ on covered companies, requiring them to calculate

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4. Where GAFAT represents the initials of the notable American multinationals that the tax is primarily targeting: Google, Apple, Facebook and Amazon.
6. See French Investigation, supra n. 2.
8. The Report, supra n. 7, at 77.
revenues attributable to France using specified formulas specified in the law.\textsuperscript{10} It seems suspiciously odd that the DST ended up targeting mainly US tech companies,\textsuperscript{11} and so one can understand the concerns expressed by the United States that the DST is US-biased. Moreover, the DST seems to contradict the current US–France tax treaty, under which digital services should only by subject to tax in France to the extent that they are provided through a Permanent Establishment (PE) in France.\textsuperscript{12} President Trump expressed his own discontent with France’s DST, tweeting that France lack the jurisdiction to tax American technology companies as proposed by the DST, and that ‘[i]f anybody taxes them, it should be their home Country, the USA’. He added that the United States ‘will announce a substantial reciprocal action on Macron’s foolishness shortly’, adding that he ‘always said American wine is better than French wine’.\textsuperscript{13} And indeed, as a result of the mounting pressure and the rising concerns from the United States would no longer be able to claim that the tax is discriminatory against American technology companies. Furthermore, VAT is not a tax covered by the United States–France tax treaty, and as such there is no requirement that the tax would only be imposed to the extent a company has a PE in France.

How exactly would VAT work with respect to American technology companies and on what earnings would it be imposed? To answer this question, we first need to better understand the interaction between Facebook and its Users.

3.1 The Interaction Between Facebook and Its Users

Think of a world where Facebook would offer access to its social platform for a monthly subscription payment. Users would then subscribe and pay each month for using the platform and would most likely be much less keen towards any collection of data and information by Facebook. As one can expect, Facebook’s income from advertisements would substantially reduce. This is because (1) Users would tolerate less ads in general when they pay a monthly subscription fee, and (2) ads would no longer be targeted (as Facebook will not be allowed to collect data on its Users) and would generate less ‘clicks’.

Would Facebook be willing to ‘give up’ the earnings from targeted ads in exchange of a cash flow of subscription payments? Facebook’s chief executive, Mark Zuckerberg provided a very clear answer to that question – no. In his response to Senator Bill Nelson’s questions in the Senate hearing on the Cambridge Analytica scandal, Zuckerberg explained that having a ‘free’ platform is an essential part of Facebook’s business model: ‘(T)o be clear, we don’t offer an option today for people to pay to not show ads. We think offering an ad-supported service is the most aligned with our mission of trying to help connect everyone in the world, because we want to

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\textsuperscript{10} See S. Seo et al., U.S. to Slap France with Tariffs Over Digital Services Tax, Tax Notes Federal Today (3 Dec. 2019).

\textsuperscript{11} About two thirds – seventeens of twenty-seven – of the multinationals expected to be covered by the DST are expected to be US-based, see the Report, supra n. 7, at 26–27.

\textsuperscript{12} Although it is not clear whether the DST is indeed a covered tax that should be subject to tax treaties.


offer a free service that everyone can afford. There is no reason to believe that Zuckerberg and Facebook are motivated by altruism, rather than business considerations (tax considerations included) aimed at maximizing profits, and so what is the reason preventing Facebook from introducing an ad-free priced subscription? The answer must be that collecting data generates more profits.

It seems safe to assume, then, that Facebook has concluded that a business model of subscription-free interaction and utilizing the collection of data would be more profitable. This might be true if advertisers are willing to pay more for having access to the platform (and for targeting their ads to a designated audience), rather than users. It might also be the case if the data collected could be used to other revenue-raising activities. As such, Facebook’s clear incentive is to utilize its algorithm, so that ads will target, as accurately as possible, its users, in a way that will generate the most amount of ‘clicks’. In order to utilize its algorithm in such way, Facebook needs data on its Users. Taking into account that targeted ads will result in greater revenue, Facebook is willing to pay for such data and information – by waiving the revenue from the subscription payments. In other words, the value of the waived subscription fee is equal to the amount Facebook would be willing to pay Users for their data. Such amount is directly related to the profitability of Facebook from running targeted ads. The more Facebook profits from targeted ads, the more it would be willing to pay Users for their data and the more Facebook would be willing to attract Users to use its platform (which is the mechanism for collecting data), in a way that would increase the Users’ value from using Facebook, and would, in turn, increase the waived subscription fees.

Facebook’s business model, and more specifically their decision to ‘give up’ subscription payments as the source of income, and instead generating profits from data collection and targeted ads, cannot, and should not, dictate the tax treatment of such profits, especially if, and when, those profits go untaxed. As such, we should recharacterize the current interaction between Facebook and its Users into two distinct transaction – the first is a subscription where Users pay a monthly subscription payment for the access to the Facebook. The second, is a monthly royalty-like fee that Facebook is paying to the Users for the right to collect data on them and show targeted ads. In other words, Facebook and its Users are involved in a barter exchange. On the one hand side, Users pay a deemed subscription fee and Facebook provides access to its platform, and on the other hand, Facebook is paying a deemed royalty-like fee Users provide their consent to the collection of data and to targeted ads. The two deemed payments are offset each other.

### 3.2 Barter Exchange

Under general principles of VAT, a taxable supply of services must be made for ‘consideration’. Consideration is generally the price, value, or amount that a buyer agrees to pay for the service provided. Such amount can be given in cash or in kind. Consideration given in-kind is a consideration given in a non-cash form, where the value of the non-cash consideration, as agreed between the parties, is respected for VAT purposes, provided that it could be shown to be an arm’s-length value. A typical barter exchange includes an in-kind consideration, where the service is provided in full or partial exchange for other supplies of goods or services. Where the consideration is given in kind, its value for VAT purposes is its fair market value. In-kind consideration is implied or arises when the service is provided without exchange of payment.

As discussed, we believe that interaction between Facebook and its Users is a barter exchange, where Users’ personal data is, in fact, consideration for the supply of digital services. Yet the valuation and quantification of such consideration still pose a major hurdle before actual VAT could be imposed. As we noted below, we believe that the amount of the deemed subscription payment and the deemed royalty-like fee are equal and offset each other, resulting in a seemingly ‘free’ interaction. This means that in order to estimate

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16 Transcript of Mark Zuckerberg’s Senate Hearing. The Washington Post (18 Apr. 2018), https://www.washingtonpost.com/news/the-switch/wp/2018/04/10/transcript-of-mark-zuckerberg-senate-hearing/ (accessed 18 Feb. 2020). Users who opt-out from targeted ads are still shown ads that can generate income to Facebook, but those ads are not targeted, but rather general. Yet note Zuckerberg’s interesting remark on general ads: ‘What we found is that even though some people don’t like ads, people really don’t like ads that aren’t relevant. And while there is some discomfort for sure with using information in making ads more relevant, the overwhelming feedback that we get from our community is that people would rather have us show relevant content than not’. Facebook does offer users to opt out of targeted ads. Yet, as Zuckerberg noted himself, ‘some people use it. It’s not the majority of people on Facebook’. See Transcript, supra n. 16. In addition, users who opt-out from targeted ads are still shown ads that can generate income to Facebook in the platform, but those ads are general, rather than targeted.

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the amount of the deemed subscription fee, we can instead estimate the amount of the deemed royalty-like payment Facebook is paying to its Users for the right to collect data and to show targeted ads. That amount, of the deemed royalty-like fee, is in turn derived from the revenue Facebook generates from the targeted ads and form the collection of data.

The immediate implication of the Barter exchange analysis is that consumption tax is due and should be collected. Let’s take France as an example. French Users are deemed to pay a subscription payment to Facebook for the right to access the platform. Such access is normally taking place in France, which is therefore, place of consumption. As such, France should have jurisdiction to impose VAT on the deemed subscription payments paid by French Users. As for the other side of the barter exchange – the deemed royalty-like fees Facebook paying to its Users – to the extent the Users are private individuals, no VAT is due, since ordinary non-commercial activities (such as disposal of personal assets – or personal data) are not generally subject to VAT. Alternatively, that deemed royalty-like fees should be subject to 0% VAT, since the fee is paid to a foreign entity (e.g. Facebook Ireland) and the processing of the data collected, for which the deemed royalty-like fee is made, is conducted outside of France (where Facebook conducts its R&D activity). In other words, the personal data is ‘exported’ outside of France and, therefore, the fee should not be subject to VAT in France.

3.3 The Valuation Problem

While the conceptual grounds for imposing VAT on the seemingly ‘free’ interaction between Facebook and its Users seem to be set in stone, a practical problem stands – how to calculate the amount of the deemed subscription payment and the resulting VAT liability. Nonetheless, we do not believe such hurdle should prevent the imposition of tax. Furthermore, while there are certain market valuation methods that can help in assessing the price users would have been willing to pay for accessing Facebook ads-free, we believe that as a first step, it would be easier (and more feasible) to calculate the deemed royalty-like payment that Facebook pays to its Users. As discussed, this payment and the deemed subscription payment are equal and offset each other.

It seems reasonable to assume, that the amount of payment Facebook would be willing to pay Users for their information bear direct link to the profits Facebook can generate from such information. Based on its financial reports and country-by-country reporting, tax authorities could estimate revenues from advertising, and by taking into account comparable profit margins, tax authorities could reliably estimate profits from advertisement. Such estimations regarding profits (and costs) could be the starting point for estimating the amount of royalty-like payments Facebook would be willing to pay to its Users. As discussed, that amount is equal to the gross receipts from the deemed subscription fees, which is the tax base for the VAT.

Clearly, the above calculations are not accurate, nor they pretend to be an ultimate reflection of the economic reality. Under the current conditions, having an accurate result is not achievable. Yet like other mechanism of the tax code, such as transfer pricing or Subpart F’s deemed divided mechanism that is based on Earnings and Profits, the calculation is aimed at getting the best result possible.

3.4 VAT and Sales Tax

Similarly to France and other countries that have VAT, we believe states in the United States should also impose their sales tax on the deemed subscription payments paid to Facebook by its Users. Similarly to VAT, sales tax also generally applies to the commercial, retail, sales or services, and as such, only the deemed subscription payments should be subject to the tax, while the deemed royalty-like payment from Facebook to its Users should generally not be subject to the sales tax.

4 Income Tax Consequences

Unlike the VAT, the barter exchange between Facebook and its Users should not yield any additional income tax liability to Facebook or to its Users. For Facebook, the deemed subscription payments, which is income to Facebook, should be completely offset by the equal deemed royalty-like payment to Users, which is a business expense to Facebook. For the Users, the deemed royalty-like payment should be

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21 Terker, supra n. 19, at 1.04(2).
22 Exports are generally zero-rated. Terker, supra n. 19, at 11.01.
23 It should be noted, that unlike income tax, consumption tax usually does not allow, when calculating the consumption tax liability, to offset payments when one payment is subject to VAT and the other is not. In our context this means, that although for income tax purposes, the deemed subscription payments, which is an income to Facebook, and the deemed royalty-like payment, which is an expense to Facebook, can offset each other, they cannot offset each other for purposes of consumption tax. This is because under consumption tax rules, a business cannot credit a payment to a payer, if that payer is exempt from consumption tax and did not pay the tax on that payment (and as noted, the deemed royalty-like payment from Facebook to its Users should generally not be subject to consumption tax, to the extent they are private individuals). See B. S. Avi-Yonah, Structuring a US Federal VAT, U. Mich. Pub. L. Working Paper No. 153 (29 May 2009).
24 See e.g. NYS sales tax, New York State, Sales and Use Tax, www.tax.ny.gov/bsu/ust/uuid.htm (accessed 18 Feb. 2020). ‘Sales tax applies to retail sales of certain tangible personal property and services’.
treated as income. On the other hand, Users should be allowed an equal deduction for the deemed subscription payment to Facebook, since such payment is incidental to the income-generating activity of allowing Facebook to collect and use data. In other words, had Users not paid the deemed subscription payment to Facebook (the expense), they would not have gained access to the platform, and as such data on them could not have been collected, such that no deemed royalty-like payments would have been paid to them (income).

5 Conclusions

The French DST created an imminent risk of a trade war between the United States and France. Such risk led President Macron to postpone the DST application to 2020. Other countries, such as Italy and Canada, would face similar pressure if and when they apply their own DST. Yet France, like other countries that have a VAT regime, together with states in the United States that impose sales tax, have additional taxing rights under their respective consumption tax regime (VAT in Europe and sale taxes in the United States). This is because the current interaction between Facebook and its Users is, in fact, a barter exchange, under which Users are paying a monthly subscription payment to Facebook for access to its platform, and Facebook is paying a monthly royalty-like payment to Users for the right to collect and use Users’ data, as well as to use targeted ads.

Under the barter exchange analysis, the deemed subscription payment should be subject to VAT or sales tax. Since the service (that is the access to the platform), for which payment is made, is consumed in the place where Users reside, tax is due in the relevant country or state of each individual User’s residence. As for the deemed royalty-like payment by Facebook to its Users, such payment should generally not be subject to VAT or sales tax, to the extent the individual Users is a private individual. The additional revenue from the imposition of VAT will offset, at minimum, lost revenues from the DST, and should not result in any trade violations under the WTO, such that the United States could not claim for trade or any other discrimination against US companies.

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