



Digital taxation enters Moldovan public debate

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EXECUTIVE SUMMARY

In its desire to make digital giants pay based on where their consumers are, Chicu Government is in step with the European and global trends. However, the new legislation can be rendered toothless if it doesn't account for extremely transnational nature of the issue in a proper way. Going alone against the companies that rake in colossal revenues by any standards can undermine the efficiency of the whole enterprise and even affect our relationship with the United States. Opportunities to find a more sustainable solution to this conundrum nevertheless remain.

Key words: *Republic of Moldova, budgetary process, fiscal policy, digital taxation.*

On 26 November the freshly appointed Government presented its draft budget for 2020. While most of the public attention has been focused on the deficit figures and matters related to social spending, one more provision stood out. Ministry of Finance came up with the proposal to oblige multinational digital companies to register legal entities in Moldova and pay VAT on the revenues they earn from Moldovan users.¹ The Ministry's estimations forecasted that this measure will bring additional 100 Million lei in the state coffers.² Expert community and wider public reacted rather skeptically, with many MPs having voiced concerns regarding its enforceability as well. As a result, the Government postponed the entering of the contested decision in force from 1 January to 1 April.

Obvious targets of the new legislation would be companies we know under the GAFA abbreviation: Google, Amazon, Facebook and Apple. It would be wise though to add a few others to this list as well, with Netflix and Airbnb standing as the brightest examples. Their business models defy conventional assumptions (less so for Apple though), which led to massive negative consequences for the international taxation regime. New digital giants neither own many physical assets nor establish presence in every jurisdiction they have customers in, their main reliance being on insights from customer data and intellectual property (IP).

Since the current tenets of international taxation were established in 1920s, the key of them was the principle of physical presence, according to which businesses pay taxes based on where their offices are located. Even before the advent of digital era, cracks in this model started appearing fast, with a lot of jurisdictions reinventing themselves as tax heavens. Moreover, when the digital companies started blossoming in the 1990s, the newly established World Trade Organization (WTO) ruled that cross-border e-commerce and

¹ Balkan Insight: *Moldova to Close Deficit by Taxing Facebook, Google*. 28 Nov 2019. Link: <https://balkaninsight.com/2019/11/28/moldova-to-close-deficit-by-taxing-facebook-google/>

² Newsmaker.md: *Минфин хочет обязать Google и Facebook платить НДС в бюджет Молдовы*. 26 Nov 2019. Link: <https://newsmaker.md/rus/novosti/minfin-hochet-obyazat-google-i-facebook-platit-nds-v-byudzhet-moldovy/>

digital businesses should not be subjected to customs duties. The taxation question was not discussed at all.

Fortunes, however, started turning against Big Tech after the episodes of Brexit referendum and US presidential election in 2016. This was one of the first moments of public waking up to the fact that their digital footprint has become a commodity (and a very profitable one), over which they as consumers have little say. More revelations followed. Facebook CEO Mark Zuckerberg had to testify before the US Senate and European Parliament, and the company has also been multiply fined by various antitrust authorities. Larry Page and Serghei Brin, Alphabet's (Google's parent company) tsars, defied the calls to testify. It remains to be seen whether their recent departure from the helm in favor of Google's boss Sundar Pichai will lead to any meaningful changes.

World powers and the general public reacted with immense backlash. GAFA gained immense bargaining power and used its clout to promote their interests with regulators worldwide. They can easily afford it, because their profits are juicy and stable, and not so long ago some of them even briefly reached \$1 trillion in market capitalization.³ However, biggest jurisdictions like the United States, the EU, India, Australia etc. realized that they also have immense leverage over the digital giants' fortunes through taxing them based on the revenues they generate from their citizens' data. EU and Organization for Economic Cooperation and Development (OECD) decided to take the mantle of leadership in repurposing the international tax regime so that GAFA would not get unfair advantages anymore.

OECD new proposals were circulated in the beginning of October and aimed to amend the Inclusive Framework on BEPS (base erosion and profit shifting).⁴ They are aiming to tackle the presence and 'scale without mass' issues and are based on an earlier report from March 2018, endorsed by 113 countries. The EU aims to adopt a union-wide digital services tax in 2020. But the disagreements between countries with different interests delay the adoption of a truly global (or at least European) solution.⁵ Moldova as a small market with no current stake in the future of digital economy even more so cannot afford itself to act unilaterally in such an environment.

The fate of France introducing a 3% digital tax of its own serves as a cautionary tale: Trump administration immediately retaliated with 100% tariffs on some of its products, claiming bias against American tech giants. Indian reluctance to let Amazon operate freely led to its exclusion from the US Generalized Scheme of Preferences (GSP), a special trade regime for developing countries which India was the main beneficiary of (and Moldova is a member). Other countries, from Italy to Israel, start going on their own as well with taxes or new significant presence tests based on number of customers. Yet it is obvious that GAFA have not changed their behavior much yet.

³ CEPS *Taxing Digital Economy: Time for Pragmatism*. 2 Dec 2019. Link: <https://www.ceps.eu/taxing-the-digital-economy/>

⁴ OECD leading multilateral efforts to address tax challenges from digitization of the economy. 9 Oct 2019. Link: <https://www.oecd.org/tax/oecd-leading-multilateral-efforts-to-address-tax-challenges-from-digitalisation-of-the-economy.htm>

⁵ KPMG *Taxing the Digital Economy*. July 2018. Link: <https://home.kpmg/xx/en/home/insights/2018/07/taxing-the-digital-economy.html>

Some may shrug off the possibility of a serious US reaction due to our insignificance for the afore mentioned companies in comparison with France and India. However, since Facebook and Google were specifically targeted by the Finance Ministry's proposal, it is unlikely that it will go completely off the radar. France was punished for less – its proposal has not stated any companies specifically but rather set certain metrics in terms of revenue and user number thresholds that were biased against American digital giants.

There are two more strategies for the government to choose from instead of going alone against digital giants without leverage, and both employ their main weapon – scale – against them. First is delaying the adoption of the new tax until 1 January 2021, when the EU will presumably have had a permanent solution in place, and its synchronization with the latter. Thus, Moldovan digital taxation regime will match the one of the biggest single market in the world, which can generate beneficial spillover effects in other spheres – for example, a faster obtaining of the GDPR adequacy decision. If the government wants to opt for a more proactive and regional approach, it would be wise to come up with the initiative of a joint Eastern Partnership task force on digital taxation, comprised of representatives of the ministries of economy, fiscal bodies and antitrust regulators. Aiming for an EaP wide digital service tax in coordination with the processes in the EU will likely be supported by the office of Margrethe Vestager, the vice-president of the European Commission whose mandate lies in this sphere.

The presence of Google (through search engine, email service and marketplace), Facebook (social network, Messenger, WhatsApp, Instagram), and other digital giants in the life of Moldovans is ubiquitous. Thus, it is the duty of the government to make sure that our citizens get a fair deal from it, but unilateral measures imposed by a small and one of the poorest countries in Europe against the behemoths who thrive on effects of scale and global reach have a very limited potential of achieving that. Their potential impact on our relationship with the US should also be considered.

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