

QUESTIONNAIRE ON DIGITAL SERVICES TAXES (DSTs)

RESPONSES ON BEHALF OF GTAP

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A. Policy Perspective

Q1 – Do you believe Digital Services Taxes (DSTs) are an appropriate response to the challenges of taxing the digital economy?

The taxation of the digital economy has emerged as one of the most pressing issues in international tax policy.

Highly digitalised business models enable multinational enterprises to generate substantial revenues in market jurisdictions without maintaining a traditional physical presence.

This reality challenges the existing nexus rules and profit allocation standards, which were designed for a very different economic environment.

Against this background, a number of jurisdictions have introduced Digital Services Taxes (DSTs) as a means of ensuring that some portion of the value created in their markets is subject to local taxation.

*From a policy perspective, DSTs may be regarded **as an appropriate, albeit second-best instrument** under certain conditions.*

They provide a visible and immediate response to the perception that digital multinationals are undertaxed in the markets where they operate.

By linking taxation to user participation and digital engagement, DSTs address, at least partially, the disconnect between value creation and taxing rights.

*Furthermore, their adoption can serve as a catalyst for **international negotiations by increasing the urgency of finding a coordinated and sustainable long-term solution**, such as the OECD/G20 Inclusive Framework's "Pillar One."*

Nonetheless, DSTs are inherently limited and problematic as a permanent solution. Being levied on gross revenues rather than net profits, they risk taxing loss-making or low-margin businesses, contrary to the principle of ability to pay.

Their unilateral and heterogeneous implementation across jurisdictions creates compliance burdens for taxpayers, risks of double or multiple taxation, and administrative inefficiencies.

DSTs also have the potential to distort investment decisions and to provoke trade tensions, particularly where their incidence is perceived as falling disproportionately on foreign-headquartered groups.

In practice, the cost of DSTs may be passed on to consumers and small businesses, undermining the policy objective of taxing multinational enterprises fairly.

For these reasons, DSTs should be viewed as transitional measures, appropriate only if narrowly targeted, carefully designed, and explicitly time-limited.

Sound policy design would include high revenue thresholds to exclude smaller businesses, clear and uniform sourcing rules, credit or deductibility against corporate income tax to mitigate double taxation, and automatic sunset clauses linked to the entry into force of a multilateral agreement.

In conclusion, we believe that while DSTs can play a role in addressing immediate concerns about the taxation of the digital economy, they are not a sustainable solution.

The long-term objective must remain the development of a coordinated international framework that modernises nexus and profit allocation rules, ensures neutrality and fairness, and provides legal certainty for both taxpayers and tax administrations.

In this sense, DSTs may be appropriate as a stop-gap measure, but their legitimacy and effectiveness are ultimately contingent upon their integration into, and eventual replacement by, comprehensive multilateral reform.

Q2 – In your view, should DSTs be replaced by a global tax framework?

In principle, DSTs should indeed be replaced by a coherent and comprehensive global tax framework.

While DSTs have served as pragmatic interim measures to address the perceived under-taxation of highly digitalised business models, they are inherently limited in scope and create significant challenges in terms of neutrality, double taxation, and international trade relations.

Their gross-basis design, sector-specific focus, and lack of coordination across jurisdictions underscore their status as transitional rather than sustainable instruments.

A global framework, such as that envisaged under the OECD/G20 Inclusive Framework's Pillar One, provides a more principled and durable solution. By reallocating taxing rights based on market participation and user contributions, such a system directly addresses the underlying nexus and profit allocation issues that prompted the adoption of DSTs in the first place. Unlike unilateral measures, a multilateral approach ensures consistency, reduces the risk of double or multiple taxation, and offers greater certainty for both taxpayers and tax administrations.

Replacing DSTs with a global agreement would also mitigate geopolitical and trade tensions. *Uncoordinated digital taxes have been a source of friction, particularly between implementing jurisdictions and countries where major multinational enterprises are headquartered. A harmonised framework would eliminate this fragmentation, thereby fostering a more stable international tax environment and promoting fairness across jurisdictions.*

We refer to Article 12B of the UN Model, which reflects the ongoing policy debate on taxation of digital services at source. While the OECD's approach relies on profit allocation and nexus re-design, Article 12B offers an alternative model based on gross-basis withholding. This highlights the diversity of policy preferences across jurisdictions and the need for inclusive dialogue that reflects developing countries' interests in source-based taxation.

Replacing DSTs with a global agreement would also mitigate geopolitical and trade tensions. Uncoordinated digital taxes have been a source of friction, particularly between implementing jurisdictions and countries where major multinational enterprises are headquartered. A harmonised framework would eliminate this fragmentation, fostering a more stable and equitable international tax environment.

Nevertheless, if a comprehensive multilateral instrument cannot be achieved in the near term, updating of DTCs/ bilateral treaties could serve as a pragmatic alternative to implement balanced source-based taxing rights consistent with either the Pillar One or Article 12B approaches. Such bilateral arrangements could offer interim coherence while maintaining momentum toward a global consensus.

In conclusion, DSTs have played a useful role in highlighting the deficiencies of the current system and in accelerating multilateral negotiations. However, they should be viewed strictly as temporary measures. Whether through a global framework or, if necessary, coordinated bilateral implementation, a reformed system should ensure a fair, neutral, and administrable allocation of taxing rights in the digital economy, ultimately allowing for the withdrawal of DSTs once sustainable agreements are in place.

*In conclusion, DSTs have played a useful role in highlighting the deficiencies of the current system and in accelerating multilateral negotiations. However, **they should be viewed strictly as temporary measures**. Whether through a coordinated global tax framework, or if necessary via updated network of bilateral treaties, any reform should ensure a fair, neutral, and administrable allocation of taxing rights in the digital economy, ultimately creating the conditions for repealing of DSTs once a sustainable and permanent framework is in place.*

Q3 – How do you evaluate the effectiveness of unilateral DSTs in addressing tax avoidance?

Unilateral Digital Services Taxes (DSTs) have limited effectiveness in addressing the problem of tax avoidance.

Their primary purpose is not to close avoidance channels in the traditional sense, such as profit shifting through transfer pricing, interest deductions, or the use of low-tax jurisdiction, but rather to compensate for structural gaps in the international tax framework. Specifically, DSTs are intended to secure taxing rights for market jurisdictions in situations where highly digitalised business models generate value without triggering a physical presence or permanent establishment under existing rules.

DSTs were originally conceived for a narrow set of business models, notably online advertising, digital marketplaces, and social media platforms, where user participation and data play a central role in value creation. In this context, a narrowly targeted scope aligns the tax base more closely with the underlying rationale of capturing revenue from user-based intangibles. It also helps reduce unintended spillovers to traditional or low-margin businesses, avoid taxing emerging activities, and contain compliance costs.

In this respect, DSTs may provide governments with a degree of short-term revenue stability and can reduce the perception that digital multinationals are able to avoid contributing fairly to the jurisdictions where their users and customers are located. They also signal political intent and may create leverage for multilateral reform.

*However, they do not directly target the mechanisms of aggressive tax planning or base erosion. Being turnover-based, DSTs apply regardless of whether avoidance strategies are in place and therefore **do not differentiate between compliant taxpayers and those engaging in aggressive tax structuring.***

*Moreover, **the unilateral and fragmented nature of DSTs raises risks of double taxation, legal disputes, compliance complexity and trade tensions, all of which can undermine their legitimacy as tools for addressing avoidance. The absence of coordination also creates distortions and compliance burdens, which can ultimately fall on consumers or smaller businesses rather than curbing avoidance by large multinational groups.***

Q4 – Should DSTs be limited to certain sectors (e.g., advertising and marketplaces), or applied more broadly?

The question of scope is central to the policy debate on DSTs. In principle, DSTs were conceived as targeted measures to address specific business models, such as online advertising, digital marketplaces, and social media platform, where user participation and network effects play a critical role in value creation.

Limiting DSTs to these sectors has the advantage of aligning the tax more closely with its underlying rationale: capturing revenues generated from user-based intangibles that are not adequately taxed under existing international rules.

This narrow scope also reduces the risk of unintended spillovers to traditional businesses, avoids taxing low-margin or emerging activities, and contains compliance costs.

*However, **there are drawbacks to a sector-specific approach.** By design, it creates uneven treatment across industries and **may introduce competitive distortions.** For instance, highly digitalised operations in sectors not covered by a narrowly defined DST could remain untaxed, while a few specific industries bear a disproportionate burden.*

Such selectivity risks being perceived as discriminatory, particularly in international trade relations, and can increase the likelihood of retaliatory measures.

Broadening DSTs to a wider range of digital services could, in theory, enhance neutrality and reduce distortions by ensuring that all digitalised businesses are treated consistently. Yet this broader application would also magnify the structural weaknesses of DSTs, most notably the risk of taxing revenues irrespective of profitability, the potential for double taxation, and the complexity of administering fragmented rules across jurisdictions. Expanding the scope could also intensify trade tensions and compliance costs without delivering a proportionate policy benefit.

*On balance, given the transitional nature of DSTs, **a narrowly targeted scope appears more defensible.** Restricting DSTs to sectors where user participation is demonstrably central to value creation helps maintain a clearer policy rationale, limits distortions, and underscores their role as temporary measures pending the adoption of a coordinated global framework.*

A broader application, while superficially more neutral, would amplify the shortcomings of DSTs and risk undermining their legitimacy as an interim instrument.

Q5 – Do you see DSTs as compatible with international tax treaties?

*DSTs generally raise significant questions of compatibility with existing international tax treaties. Most treaties, based on the OECD and UN Models, govern the allocation of taxing rights with respect to **income taxes** on business profits, dividends, interest, and royalties. DSTs, by contrast, are typically designed as **gross-basis levies on turnover** from specific digital activities, and they are often legislated as taxes outside the scope of “covered taxes” in bilateral treaties. As such, they fall outside the scope of “covered taxes” under bilateral treaties and are therefore not eligible for double taxation relief.*

On this basis, many jurisdictions introducing DSTs argue that these measures do not technically fall within the scope of tax treaties and therefore do not breach treaty obligations.

*However, the legal formality that places DSTs outside treaty coverage does not resolve all concerns. From a substantive perspective, DSTs can be perceived as circumventing the protections treaties are intended to provide, particularly the principles of **non-discrimination, relief from double taxation, and exclusive taxing rights absent a permanent establishment**. In practice, DSTs may give rise to double taxation where the same revenues are also subject to corporate income tax in the jurisdiction of residence, without an effective mechanism for relief. This tension undermines the spirit, if not the letter, of international tax treaty commitments.*

Moreover, because DSTs are often sector-specific and predominantly affect large multinational enterprises headquartered in a limited number of countries, they are frequently perceived as discriminatory, which can fuel trade disputes and erode trust in the international tax framework. This highlights a deeper incompatibility between unilateral DSTs and the cooperative ethos that tax treaties are meant to embody.

*In conclusion, while DSTs may be formally structured to remain outside the scope of tax treaties, their substantive effects often conflict with treaty objectives and principles. For this reason, DSTs should be regarded as **at best imperfectly compatible**, and only as transitional measures. The long-term solution lies in replacing DSTs with a coordinated multilateral framework, such as the OECD/G20 two-pillar solution, that directly addresses nexus and profit allocation challenges while remaining fully consistent with international treaty obligations.*

B. Future Outlook

Q6 – Should countries maintain DSTs until a global consensus is reached?

*The question of whether countries should maintain DSTs until a global consensus is reached must be assessed **in light of both their policy rationale and their practical consequences**.*

On the one hand, DSTs have served as an important interim tool, enabling jurisdictions to secure some degree of taxing rights over highly digitalised business models that would otherwise fall outside the scope of traditional nexus rules.

For many governments, maintaining DSTs provides immediate revenue, addresses perceptions of unfairness in the taxation of large multinational enterprises, and keeps political pressure on the international community to deliver a coordinated solution.

On the other hand, the continued proliferation and maintenance of unilateral DSTs comes with considerable risks. They generate double taxation where revenues are taxed both at source and in the country of residence, without relief mechanisms. They impose compliance burdens on multinational businesses forced to navigate fragmented rules across multiple jurisdictions. They may also distort competition by applying narrowly to certain digital sectors while leaving others unaffected.

*From a policy standpoint, therefore, DSTs should not become a long-term fixture. They are at best a temporary and second-best solution, **whose legitimacy depends on their role as a stop-gap measure rather than a substitute for comprehensive reform**.*

Countries may decide to maintain them in the short run as leverage and revenue tools, but their retention should be explicitly tied to clear conditions: sunset clauses, firm commitments to withdraw them once a global agreement (such as the OECD/G20 Pillar One framework) enters into force, and safeguards to mitigate double taxation and discrimination in the interim.

*In conclusion, **DSTs may justifiably be maintained on a strictly transitional basis**, but only with clear limitations and an unequivocal commitment to dismantle them once a global consensus is operational. Their continued existence beyond that point would undermine the coherence, neutrality, and cooperative spirit of the international tax system.*

Q7 – What should be the key principles guiding the taxation of digital activities in the future?

The taxation of digital activities should be guided by principles that ensure fairness, neutrality, and sustainability in the international tax system, while providing certainty for both governments and businesses.

Several key principles stand out as essential.

1. Neutrality and equity

Tax rules should apply to digital and traditional business models in a consistent manner, avoiding special regimes that distort competition or target specific sectors.

Neutrality helps ensure that businesses compete on commercial grounds rather than on the basis of tax arbitrage.

2. Alignment with value creation

Taxing rights should be allocated in line with where economic value is genuinely created.

For highly digitalised models, this includes recognising the contribution of market jurisdictions, user participation, and intangible assets, while maintaining coherence with broader transfer pricing and profit allocation principles.

3. Prevention of double taxation

Future rules must minimise the risk of overlapping claims by different jurisdictions.

Effective dispute resolution mechanisms, clear allocation rules, and robust relief systems are critical to avoid multiple taxation of the same income.

4. Simplicity, administrability and flexibility

Complex and fragmented unilateral measures create uncertainty and heavy compliance costs.

A future framework should be based on clear, standardised rules that are straightforward to administer for tax authorities and predictable for taxpayers.

5.Certainty and stability

Businesses require predictable tax outcomes in order to make long-term investment decisions. Stable rules, agreed at multilateral level, are necessary to build trust and reduce disputes.

6.Cooperation and multilateralism

The digital economy is inherently global. Sustainable taxation cannot be achieved through unilateral action alone; it requires coordinated rules underpinned by international agreements, such as those developed under the OECD/G20 Inclusive Framework.

7.Proportionality

Tax measures should be carefully calibrated to achieve legitimate policy goals without stifling innovation or disproportionately burdening emerging and smaller businesses. High thresholds and targeted scope can ensure that rules focus on large-scale, highly digitalised activities.

*In summary, **the future taxation of digital activities should be guided by neutrality, fairness, and coherence with international standards. It should provide governments with a fair share of taxing rights while preserving certainty for businesses and avoiding harmful fragmentation. Only a cooperative, principle-based approach can deliver a tax system fit for the digital age.***