

# THE DIGITAL PLATFORM ECONOMY AND ITS CHALLENGES TO TAXATION

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## THE DIGITAL PLATFORM ECONOMY AND ITS CHALLENGES TO TAXATION

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### *Abstract*

*Digitalization is transforming many aspects of our everyday lives, including the global business landscape. One of the most distinct features of the digital economy is the rise of platforms. Digital platforms not only change the supply chain in many industries but also create fundamental challenges for established tax principles. This paper will cover two of the most imminent challenges.*

*The first part of the paper is dedicated to the taxation of digital platforms themselves. According to international tax law, income taxation shall be linked to the source of the income. The current tax system assumes that a company will only create taxable income in a non-resident country, if there is some physical nexus with that country (e. g. a permanent establishment). However, many platforms in the digital economy offer their services to customers worldwide without having any physical presence in countries where the customers are located. This raises the question as to whether income taxation of platforms should be linked to the country of residence of the customers of a digital platform rather than the country of residence of the platform operator. In this regard, the initiatives of the European Commission on the digital services tax and the significant digital presence will be evaluated.*

*The second part of the paper covers enforcement issues created by the platform economy. As transactions between different user groups of a platform, it is oftentimes difficult for tax authorities to determine tax liabilities. The paper will, therefore, suggest alternative mechanisms to ensure taxation. The focus will be on the withholding tax system, which obliges platform operators to deduct the tax on behalf of platform users. Whether and to what extent the operator of sharing economy platforms can be held liable remains to be discussed.*

## I. TAXATION OF DIGITAL PLATFORMS

### A. Introduction

Following the ‘business goes global, taxes stay local’ principle, deficits of international corporate taxation are exploited through clever tax planning.<sup>1</sup> Large multinational enterprises like Airbnb, Alphabet, Apple, Facebook or Amazon are being criticized for not paying adequate taxes. Their innovative digital business models are challenging the established tax system.<sup>2</sup>

International taxation is based on the “taxation at source” principle. According to this doctrine, international income flows are subject to taxation in the country where income is derived from – regardless of the country of residence of the person achieving that income.<sup>3</sup> Profits should be taxed where the value is created.<sup>4</sup> In principle, however, according to the current tax law system income is only taxed in the source state if the taxpayer has a physical nexus to that state. Traditionally, the most important nexus for this limited tax liability is a permanent establishment or appointment of a permanent representative in a country.<sup>5</sup> In the digital world, the number of cross-border transactions has been increasing significantly. A special feature of digital business models is their global activity across

<sup>1</sup> See Norbert Herzig, *Globalisierung und Besteuerung* [Globalization and Taxation], 1998 DIE WIRTSCHAFTSPRÜFUNG 280; Adrian Cloer & Cosima Gerlach, *Die „virtuelle Betriebsstätte“: Ein angemessenes Instrument zur Besteuerung der „digitalen Wirtschaft“?* [The “Virtual Permanent Establishment”: An Appropriate Instrument for Taxing the Digital Economy], 100 FINANZRUNDschau [FR] 105, 106 (2018).

<sup>2</sup> See Stephan Eilers & Florian Oppel, *Die Besteuerung der digitalen Wirtschaft: Trends und Diskussionen. Überblick über die Arbeiten der OECD und EU mit kritischer Einordnung* [Taxation of the Digital Economy: Trends and Discussions. Overview of the Work of the OECD and EU with Critical Classification], 27 INTERNATIONALES STEUERRECHT [ISTR] 361, 362 (2018); Joachim Englisch, *Seminar G: VAT and Direct Taxation of the Digital Economy*, 25 ISTR 717 (2016); Marcel Olbert & Christoph Spengel, *International Taxation in the Digital Economy: Challenge Accepted?* WORLD TAX J. 3, 4 (2017).

<sup>3</sup> See DIETER BIRK & MARC DESENS & HENNING TAPPE, STEUERRECHT [TAX LAW] 402 et seq. (21st. ed. 2018).

<sup>4</sup> See European Commission: *Commission Staff Working Document — Impact Assessment Accompanying the Document 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, 8.

<sup>5</sup> See EINKOMMENSTEUERGESETZ [ESTG] [GERMAN INCOME TAX LAW] § 49 (1) Nr. 2 a); Birk et al., *supra* note 3, at 410-11; KOLJA VAN LÜCK, STEUERRECHT UND DIGITAL ECONOMY. LÖSUNGSANSÄTZE SACHGERECHTER BESTEuerung MULTINATIONALER UNTERNEHMEN DER DIGITALISIERTEN WIRTSCHAFT [TAX LAW AND DIGITAL ECONOMY. SOLUTIONS OF PROPERTY TAXATION OF MULTINATIONAL ENTERPRISES OF THE DIGITALIZED ECONOMY] 82 et seq. (2018).

borders regardless of their locations. From the perspective of the source state principle, this leads to two challenges: First, there is an increase in the number of direct transactions in which foreign platforms like Airbnb derive income from doing business in a country but do not use a physical presence in this country for this purpose. The question is whether the source principle requires taxation in the state in which the customers of a digital company are located. If this is answered affirmatively, the question arises as to which connecting factor should be chosen for taxation in the source state.

In order to tackle this problem, the European Commission has published a proposal for a directive laying down rules relating to the corporate taxation of a significant digital presence rather than a permanent establishment<sup>6</sup> and, as a short-term solution, has put forward a proposal for a digital services tax.<sup>7</sup> Austria and France have already introduced digital services taxes unilaterally.

### *B. Challenges of Taxing Digital Transactions*

In the internet economy, the number of direct transactions has increased dramatically. From the perspective of taxation, this leads to two central problems regarding substantive tax law: On the one hand, there is a massive loss of tax revenues in countries that are net importers of digital services, because these services are usually not taxed in the country of destination if there is no physical presence like a permanent establishment or a permanent representative there.<sup>8</sup> However, digitalization has enabled businesses in many sectors to access a great number of customers around the globe without having any physical presence in the countries where the customers are located. Therefore, some highly digitalized are achieving operational 'local scale without local mass'.<sup>9</sup> This is supported by the fact that digital business models are dominated by intangible assets.

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<sup>6</sup> See *Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence*, COM(2018) 147 final (Mar. 21, 2018) [hereinafter *COM(2018) 147 final*].

<sup>7</sup> See *Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services*, COM(2018) 148 final (Mar. 21, 2018) [hereinafter *COM(2018) 148 final*].

<sup>8</sup> See Lück, *supra* note 5, at 82 et seq.

<sup>9</sup> See OECD, *TAX CHALLENGES ARISING FROM DIGITALISATION – INTERIM REPORT 2018: INCLUSIVE FRAMEWORK ON BEPS*, OECD/G20 BASE EROSION AND PROFIT SHIFTING PROJECT 24 (2018).

Intellectual property and intellectual property rights are of utmost importance. Moreover, data and user participation are regularly decisive factors in digital business models.<sup>10</sup> Therefore, digital business models are covered inadequately by the applicable international taxation concepts.<sup>11</sup>

This does not only have a negative effect on the tax basis of net importing countries but also potentially distorts competition between digital business models and analog business models if only analog business models are subject to taxation in the source state. The European Commission estimates that the effective tax rate for digital companies such as social media companies, sharing economy platforms and online content providers is about half of that of traditional companies – and often much less. On average, digitalized businesses are facing an effective tax rate of only 9.5 %, compared to 23.2 % for traditional business models.<sup>12</sup> Thus, there is a need for a new tax framework that is up to date with the innovative digital business models.

### *C. Characteristics of the Digital Platform Models*

Although most digital business models use websites, applications or similar interfaces to sell their products and interact with customers, differences in their specific features can be identified.<sup>13</sup> To get a better understanding of the phenomenon of ‘digital economy’ and to analyze and create new chargeable events to reform the tax system, the characteristics of the digital business models must be outlined first. In general, the enterprises of the digital economy can be classified in different groups of typical business models with the multi-sided platforms being the most important ones.<sup>14</sup>

<sup>10</sup> See *id.* at 23 et seq., at 51 et seq.; Reimar Pinkernell, *DER OECD-Diskussionsentwurf zu den steuerlichen Herausforderungen der „Digital Economy“* [The OECD Draft Discussion on the Tax Challenges of the “Digital Economy”], 23 ISTR 273, 275 (2014); Wolfgang Schön, *International/OECD – Ten Questions about Why and How to Tax the Digitalized Economy*, 72 BULL. INT’L TAX’N [BIT] 378 (2018), [https://research.ibfd.org/#/doc?url=/linkresolver/static/bit\\_2018\\_04\\_int\\_1#bit\\_2018\\_04\\_int\\_1](https://research.ibfd.org/#/doc?url=/linkresolver/static/bit_2018_04_int_1#bit_2018_04_int_1).

<sup>11</sup> See Johannes Becker, *Seminar C: Besteuerung einer digitalen Präsenz* [Seminar C: Taxation of digital presence], 27 ISTR 634, 635 (2018).

<sup>12</sup> See European Commission, *Communication from the Commission to the European Parliament and the Council: Time to Establish a Modern, Fair and Efficient Taxation Standard for the Digital Economy*, COM(2018) 146 final (Mar. 21, 2018) [hereinafter *COM(2018) 146 final*], at 4.

<sup>13</sup> See Eilers & Oppel, *supra* note 2, at 363.

<sup>14</sup> See OECD, *supra* note 9, at 30-31 (2018).

Multi-sided platforms interact as intermediaries which enable different users or user groups to interact with each other. Prominent examples are Airbnb, Uber, Didi, Baidu, and WeChat. These platforms are oftentimes characterized by indirect network effects, which means that an increase in end-users on one side of the market gives rise to the utility for end-users on the other market side. Illustrated by the example of the online platform Airbnb, which helps individuals to rent accommodations by linking hosts and guests, this means: Both types of end-users (the hosts and the guests) indirectly benefit if there are more end-users on the other side of the market. Guests benefit from having more hosts to choose from and hosts benefit from having more potential guests.<sup>15</sup> In this respect, platforms act as intermediaries between different user groups (customers and suppliers). In some cases, the platform operators themselves also act as providers. However, the platform operators' business model is usually based on the fact that they receive an agency fee when a transaction occurs. Some platforms are also financed through advertising by selling their users' data to advertisers or by giving advertisers access to users. The platform operators generate income from their users for making the platform available. A second way of generating revenue is to monetize users' data for advertising. The difficulty from a taxation point of view is therefore that platform operators generate income without having a physical presence at the location of their users. The traditional source taxation principle thus reaches its limits. This applies in particular when platform operators monetize user data, i.e. use a resource without being subject to taxation at the source of this resource (the user's location).

#### *D. Proposals for Taxation of Digital Platforms*

The European Commission's two key approaches for a fair taxation of digital business models are the introduction of a digital

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<sup>15</sup> See Marshall W. Van Alstyne & Geoffrey G. Parker & Sangeet Paul Choudary, *Pipelines, Platforms, and the New Rules of Strategy*, HARV. BUS. REV. 54, 56 (2016); ANDREW MCAFEE & ERIK BRYNJOLFSSON, *MACHINE, PLATFORM, CROWD: HARNESSING OUR DIGITAL FUTURE* 140 et seq. (2017); OECD, *supra* note 9, at 29; Karl Täuscher & Romy Hilbig & Nizar Abdelkafi, *Geschäftsmodelle mehrseitiger Plattformen [Multilateral Platform Business Models]*, in *DIGITALE TRANSFORMATION VON GESCHÄFTSMODELLEN: GRUNDLAGEN, INSTRUMENTE UND BEST PRACTICES* 179, 183 (Daniel Shallmo et al. ed., 2017); Feng Zhu & Nathan Furr, *Products to Platforms: Making the Leap*, HARV. BUS. REV. 72, 74 (2016).

presence as nexus for international taxation and the establishment of a new digital services tax.

### 1. Digital Presence Instead of Permanent Establishment

In order to tackle the problem of inadequate taxation of the digital economy, one reform proposal by the EU is the introduction of a new concept of a digital presence.

Probably the biggest challenge in taxing digital business models is that they can be operated without any physical presence. At the same time, international taxation rules require a physical nexus for taxation. Thus, one proposal implies the modification of the nexus for taxation. For this purpose, the concept of a permanent establishment is to be extended to include a significant digital presence.<sup>16</sup> According to the proposal of the EU Commission, a ‘significant digital presence’ shall be constituted if a business consists wholly or partly of the supply of digital services through a digital interface.<sup>17</sup> A ‘digital interface’ is defined as ‘any software, including a website or a part thereof and applications, including mobile applications, accessible by users’.<sup>18</sup> ‘Digital services’ are ‘services which are delivered over the internet [...] and the nature of which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology’.<sup>19</sup> Examples are the supply of digitized products (e.g. software); services providing or supporting a business or personal presence on an electronic network (e.g. a website); providing storage space in the internet (cloud services from); streaming or downloading of music, films or games (Spotify, Netflix, App Stores); or the transfer of rights to put goods or services on an internet site operating as an online market (e.g. sharing economy platforms like Airbnb).<sup>20</sup>

A digital presence is ‘significant’ in a country if the company satisfies one of the following three criteria: First, it exceeds a threshold of 7 million euros in annual revenues from digital services in a country. Or second, it has more than 100,000 users who access

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<sup>16</sup> COM(2018) 147 final, *supra* note 6, at 7.

<sup>17</sup> See COM(2018) 147 final, *supra* note 6, art. 4 (3), at 16.

<sup>18</sup> See COM(2018) 147 final, *supra* note 6, art. 3 (2), at 14.

<sup>19</sup> See COM(2018) 147 final, *supra* note 6, art. 3 (5), at 14.

<sup>20</sup> See COM(2018) 147 final, *supra* note 6, art. 3 (5), at 14-15.

its digital services in a country in a taxable year. The third category of a significant digital presence will be if the company creates over 3,000 business contracts for digital services with business users in a taxable year.<sup>21</sup>

However, the concept of a permanent establishment alone is not sufficient to ensure effective taxation of profits in the source state of the service. The allocation of profits to the digital establishment is of essential importance.<sup>22</sup> Taxation shall be guaranteed in the country in which the digital activities of the company are concentrated.<sup>23</sup> That is the place where most user activity takes place.<sup>24</sup> In this way, the traditional understanding of value creation is reversed: While the conventional view is that value creation takes place where goods and services are created using means of production, now the place of the highest demand is relevant for the determination.<sup>25</sup> Therefore, the focus must be on collection, storage and processing of user-level data and of user-generated content, the sale of online advertising space and supply of third-party created content on digital marketplaces.<sup>26</sup> The country where a user's device is used shall be determined by reference to the Internet Protocol (IP) address.<sup>27</sup>

Hence, this reform approach addresses two of the main problems that states encounter when it comes to taxing digital activities: First, under the proposed new rules, states will be able to tax profits arising from digital activities that are generated in their territories, even if these companies do not have a physical presence in that country. A significant digital presence will allow states to tax profits generated in their territories. Second, the allocation of profits, which depends on the companies' value creation, will be based on new factors such

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<sup>21</sup> COM(2018) 147 final, *supra* note 6, art. 4 (3), at 16.

<sup>22</sup> See Francesco Faruggia-Weber, *Signifikante digitale Präsenz und Digitalsteuer – Gedanken zu den Richtlinienvorschlägen der EU-Kommission zum „einjährigen Jubiläum* [Significant Digital Presence and Digital Tax - Thoughts on the Commission's Proposals for a "One-Year Anniversary"], DEUTSCHES STEUERRECHT [DSTR] 638, 640 (2019); Daniel Zöller, *Die Besteuerung der digitalen Wirtschaft – sinnvolle Reformen oder steuerpolitischer Aktionismus?* [The Taxation of the Digital Economy - Meaningful Reforms or Tax Actionism?], 73 BETRIEBS-BERATER [BB] 2903, 2907 (2018).

<sup>23</sup> See Faruggia-Weber, *supra* note 22.

<sup>24</sup> See Albert Schlund, *Vorschläge der Europäischen Kommission für eine Besteuerung der digitalen Wirtschaft* [Proposals of the European Commission for a Taxation of the Digital Economy], DSTR 937, 940 (2018).

<sup>25</sup> See Faruggia-Weber, *supra* note 22.

<sup>26</sup> See COM(2018) 147 final, *supra* note 6, art. 5 (5), at 17.

<sup>27</sup> See COM(2018) 147 final, *supra* note 6, art. 4 (6), at 17.



as user data and will thereby better reflect the value creation of digital companies.

## 2. Digital Services Tax

Furthermore, the EU Commission proposed a digital services tax in order to target the most urgent gaps and loopholes in the taxation of digital activities. It is designed to ensure that activities which are not currently effectively taxed generate immediate revenues for states. The aim is to create a level playing field for all businesses, whether EU or non-EU based, large or small, more or less digitalized.<sup>28</sup> A number of countries already have a similar tax in place, including Austria, France, Israel, India and some US states.

The EU proposal for a digital tax essentially proposes a sales-related special tax on certain digital services.<sup>29</sup> It should only be used as a temporary measure in order to prevent distortions of competition until a more comprehensive solution is established. The aim of the digital services tax is the taxation of digital services, to which the user makes a decisive contribution to the value creation. Within these services, the mismatch between the place of taxation of profits and the place of value creation (the user) is typically most obvious.<sup>30</sup> Digital services which depend on user involvement can be categorized into two groups: First, services where the main value is created by user data, either through advertising or by the sale of data collected by companies such as social media or search engines. This includes in particular business models of companies such as Google or Facebook. Second, services of supplying digital platforms that facilitate interaction between users, who then can exchange goods and services via the platform (such as sharing economy platforms).<sup>31</sup> Examples are Airbnb, Uber, eBay or Amazon Marketplace.<sup>32</sup> The

<sup>28</sup> COM(2018) 148 final, *supra* note 7, at 7 et seq.

<sup>29</sup> COM(2018) 148 final, *supra* note 7, at 7 et seq.; Monika Wünnemann, *Herausforderungen der Besteuerung der digitalen Wirtschaft im Jahr* [Challenges of Taxation in the Digital Economy], 28 ISTR 134, 135 (2019); Zöller, *supra* note 22.

<sup>30</sup> COM(2018) 148 final, *supra* note 7, at 16.

<sup>31</sup> See COM(2018) 148 final, *supra* note 7, art. 3 (1), at 24.

<sup>32</sup> See Johannes Becker & Joachim Englisch, *Ausgleichsteuer – Ein mangelhafter Schnellschuss* [Countervailing Tax - A Poor Quick Shot], <https://makronom.de/ausgleichsteuer-steuern-digitale-unternehmen-eu-kommission-google-facebook-ein-mangelhafter-schnellschuss-25751>; Eilers & Oppel, *supra* note 2, at 366; Daniel Rüschler, *Vorschlag für eine europaweite Digitalsteuer zur Erfassung digitaler Geschäftsmodelle in der digitalen Wirtschaft* [Proposal for a Pan-European Digital Tax to

taxation of platform services is justified by the fact that users make a significant contribution to the creation of value, especially because of the network effects they create.<sup>33</sup> However, transactions between users are not taxed.<sup>34</sup>

The digital services tax shall only apply to large companies and companies with a significant digital footprint in the EU, and therefore a company is only subject to taxation if two thresholds are met: The tax will only apply to companies with total annual worldwide revenues of 750 million euros and annual EU revenues of 50 million euros.<sup>35</sup>

A tax rate of 3% has been proposed, since this is considered to be an appropriate balance between revenues generated by the tax and accounting for the differential impact for businesses with different profit margins.<sup>36</sup> The tax rate of 3% could generate an estimated 5 billion Euros tax revenues a year. This uniform rate, once applied throughout the EU, would help to avoid ‘tax shopping’ and distortions in the European Single Market.<sup>37</sup>

The tax shall be collected by the states in which users are located, independent of the location of the company which provides the digital service.<sup>38</sup> This is the place from which users’ access the digital interface with their digital device (IP address).<sup>39</sup> The tax revenue is distributed amongst the states according to a distribution key.<sup>40</sup> It depends on how often the taxable event has occurred in each country.<sup>41</sup> In order to avoid double taxation, the digital services tax shall be deducted as a cost from the corporate income tax base.<sup>42</sup> The interim tax shall be based on a system of self-declaration by taxpayers. Member States will be able to carry out tax audits to

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*Capture Digital Business Models in the Digital Economy*], 6 MEHRWERTSTEUERRECHT [MWSTR] 419, 422 (2018).

<sup>33</sup> See COM(2018) 148 final, *supra* note 7, at 8.

<sup>34</sup> See COM(2018) 148 final, *supra* note 7, at 17.

<sup>35</sup> See COM(2018) 148 final, *supra* note 7, art. 4 (1), at 25.

<sup>36</sup> See COM(2018) 148 final, *supra* note 7, at 22.

<sup>37</sup> See COM(2018) 148 final, *supra* note 7, at 22.

<sup>38</sup> See COM(2018) 148 final, *supra* note 7, art. 5 (1), at 27.

<sup>39</sup> See Eilers & Oppel, *supra* note 2, at 366; Faruggia-Weber, *supra* note 22, at 642; Matthias Valta, *Verfassungs- und Abkommensrechtsfragen des Richtlinienentwurfs für eine Steuer auf digitale Dienstleistungen* [Constitutional and Treaty Law Issues of the Draft Directive for a Tax on Digital Services], 27 ISTR 765, 766 (2018).

<sup>40</sup> See COM(2018) 148 final, *supra* note 7, art. 5 (3), at 27-28.

<sup>41</sup> See Eilers & Oppel, *supra* note 2, at 367; Rüschler, *supra* note 32, at 419, 424.

<sup>42</sup> See COM(2018) 148 final, *supra* note 7, at 20.

monitor if taxpayers are fulfilling their obligations. A digital portal, known as the One-Stop-Shop system, will be set up to enable companies to fulfill all tax obligations at once.<sup>43</sup>

### 3. Assessment of the Proposed Reforms

The new proposals would need a unanimous agreement of all Member States of the EU in order to become law. Until today, however, the EU Member States could neither agree on a reform of the permanent establishment nexus towards a significant digital presence nor the introduction of a digital services tax. Instead, France and Austria introduced digital services taxes unilaterally. This is certainly the worst of all approaches, as it creates a patchwork of tax rules. This runs counter to the interests of the EU Member States as well as of digital companies. First of all, this creates an inevitable risk of both double taxation and non-taxation. Both can lead to considerable distortions of competition not only between analog and digital business models, but also between digital business models. Second, a patchwork of legal rules increase compliance cost for affected companies and decrease legal security and predictability for them. Thus, there is a need for a prompt multilateral, international reform that leads to a harmonized approach. The question is whether the EU proposals provide for an adequate blueprint for such an international or multilateral approach.

#### *(a) Assessment of the Digital Services Tax*

The digital services tax is essentially a special tax that has both the characteristics of a consumption tax and an income tax.<sup>44</sup> In view of the existing international taxation structure, this structure bears enormous potential for conflict: First of all, it is questionable whether that fits to established international tax law principles: According to Art. 2 of the OECD's Model Agreement (MA), double taxation agreements are only applicable to taxes on income and on capital. As the aim of the digital services tax shall be the compensation for inadequate company taxation, the digital services tax could be characterized as an income tax.<sup>45</sup> In this case, however, the digital services tax is in tension with Art. 7 (1) of the OECD's MA

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<sup>43</sup> See COM(2018) 148 final, *supra* note 7, at 22.

<sup>44</sup> See Eilers & Oppel, *supra* note 2, at 369.

<sup>45</sup> See Valta, *supra* note 39, at 771-772.

according to which profits of an enterprise are taxable only in the resident state unless the enterprise carries on business in the other state through a permanent establishment situated therein. If the requirement of the existence of a permanent establishment is not met, which will often be the case for the digital services tax, profits are not subject to any income taxation regarding the OECD MA. Accordingly, the digital services tax would not have any scope of application in the case of double taxation agreements.<sup>46</sup> The levying of the digital services tax would therefore only be possible through an amendment of existing double taxation agreement of a treaty override.

If the digital services tax is characterized as a consumption tax there is a risk of double taxation according to the current VAT rules.<sup>47</sup>

Lastly, the benefits of such a tax are questionable.<sup>48</sup> The administrative burden for companies and states is estimated to be very high, especially in view of the new allocation mechanism. The revenue effects, on the other hand, are relatively small. The European Commission is assuming that the digital services tax would generate only 5 billion euros annually in revenues within the EU.<sup>49</sup> The deduction from the corporate tax base further reduces the effective tax revenues for the member states. Moreover, it must be considered that digitalization will affect all sectors of the economy, which makes it nearly impossible to single out digital versus non-digital transactions.<sup>50</sup> Finally, the aim of the reform should not be to establish a specific tax regime for digital services and other digitalized business models as such a separate framework would drive an inefficient separation between digital and non-digital sectors.

Overall, the digital services tax bears a risk of double taxation and unprofitable cost expenditure.

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<sup>46</sup> See Juliane Kokott, *Herausforderungen einer Digitalsteuer* [The Challenges of a Digital Tax], 28 ISTR 123, 129 (2019); Valta, *supra* note 39, at 772.

<sup>47</sup> See Eilers & Oppel, *supra* note 2, at 369.

<sup>48</sup> See Eilers & Oppel, *supra* note 2, at 369.

<sup>49</sup> See COM(2018) 146 final, *supra* note 12, at 9.

<sup>50</sup> See Karina Ponomareva, *European Union/OECD/International — Comparison of Proposals to Adjust the Permanent Establishment Concept to the Digital Economy*, 73 BIT (2019), [https://research.ibfd.org/#/doc?url=/collections/bit/html/bit\\_2019\\_11\\_e2\\_1.html](https://research.ibfd.org/#/doc?url=/collections/bit/html/bit_2019_11_e2_1.html); Schön, *supra* note 10.

*(b) Assessment of the Significant Digital Presence*

The introduction of a significant digital presence as a new nexus for international taxation is a solution to cover digital services and allocate the taxation of revenues according to the place where the user of the data is generated. Multinational enterprises could be taxed, even if they have no physical nexus in a state.

Also, this part of the EU reform proposal has some significant problems. First, the definition of ‘value creation’ would be reformed. However, the content of the concept of value creation is rather vague. It is often argued that the place of residence of the user is the place of consumption, but not the place of value creation.<sup>51</sup> Meanwhile, the place of value creation is where the user data is evaluated, thus, the location of the company offering the digital service.<sup>52</sup> In addition, the definition of digital services has been formulated very broadly by the EU Commission. This will create problems in classification issues, especially when companies with traditional business models contain elements of digitalized business models.<sup>53</sup> The disadvantage of a definition that is too broad is illustrated by the following example: A company that operates a cross-border mail order business for physical books is taxed on its physical presence. If it switches its business model to the sale of digital substitutes (e-books), the place of consumption is decisive.<sup>54</sup>

If the idea of a digital presence shall be an adequate measure at all, it must be established at a global level – even beyond the EU level. Otherwise, double taxation will be imminent if on one hand, states tax a digital presence of companies and on the other hand, the state of residence enforces taxation rights based on the same income.<sup>55</sup> Thus, a reform proposal that only covers EU issues is not sufficient.

The EU Commission’s proposal on the introduction of a digital services tax as well as on a significant digital presence is simply not practicable at present. The EU should, therefore, rather work towards

<sup>51</sup> See Reimar Pinkernell, *Grenzüberschreitendes digitales Wirtschaften (Ertragsteuerrecht)* [Cross-Border Digital Business (Income Tax Law)], in *DIGITALISIERUNG IM STEUERRECHT* 321, 356 (Johanna Hey ed., 2019).

<sup>52</sup> See Becker & Englisch, *supra* note 32; Eilers & Oppel, *supra* note 2, at 370.

<sup>53</sup> See Kokott, *supra* note 46, at 123, 131; Zöllner, *supra* note 22, at 2903, 2904.

<sup>54</sup> See Pinkernell, *supra* note 51, at 365.

<sup>55</sup> See Eilers & Oppel, *supra* note 2, at 370.

an international consensus that leads to useful results for taxing the digital economy.

## II. LIABILITY OF PLATFORMS FOR TAX EVASION IN THE SHARING ECONOMY

The focus of the second part of this paper are transactions that occur through the sharing economy platforms. The platform economy not only creates new challenges for tax law with regard to the taxation of the platform operators themselves. Platforms are used to process a large number of transactions, which in turn are taxable. The taxation of such transactions via platforms is less problematic regarding taxability. Rather, questions of the enforceability of taxation claims arise here.

### A. Introduction

The sharing of cars, clothing or the own home via online platforms or apps has become an increasing trend.<sup>56</sup> This business model is characterized by a facilitator operating a website or an application on a mobile device and thereby connecting providers (e. g. sellers or accommodation hosts) and users (e. g. buyers or renters).<sup>57</sup> The provided goods or services are for collective use.<sup>58</sup> The owner of these goods may be the sharing platform operator itself (e. g. the short-term commercial car-sharing) or the users of the platform who offer their goods online (e. g. private accommodation via Airbnb). In the latter cases, the platform only acts as an

<sup>56</sup> See Aleksandra Bal, *United Kingdom/European Union – Managing EU VAT Risks for Platform Business Models*, 72 BIT (2018), No. 4a/Special Issue, doc&url=/collections/bit/html/bit\_2018\_4a\_e2\_1.html; NIKOLAS BEUTIN, *SHARE ECONOMY 2017. THE NEW BUSINESS MODEL* 5, 9 et seq. (PricewaterhouseCoopers GmbH ed., 2018), <https://www.pwc.de/de/digitale-transformation/share-economy-report-2017.pdf> (last visited Dec. 12, 2019).

<sup>57</sup> See Sebastian Henke, Jan Singbartl & Josef Zintl, *Mietwohnüberlassung an Touristen: Wimdu, Airbnb & Co. aus zivilrechtlicher Perspektive. Neues von der “kollaborativen Wirtschaft”* [Rental Accommodation to Tourists: Wimdu, Airbnb & Co. from a Civil Law Perspective. News from the “Collaborative Economy”], 2018 NZM 1, 2; Christian Solmecke & Bonny Lengersdorf, *Rechtliche Probleme bei Sharing Economy. Herausforderung an die Gesetzgebung auf dem Weg in eine geteilte Welt* [Legal Problems with the Sharing Economy. Legislative Challenge on the Way to a Divided World], 18 MULTIMEDIA UND RECHT [MMR] 493, 494.

<sup>58</sup> See Federal Ministry for Economic Affairs and Energy, *Sharing Economy in Germany*, 2 (2018), [https://www.bmwi.de/Redaktion/EN/Publikationen/Studien/sharing-economy-im-wirtschaftsraum-deutschland.pdf?\\_\\_blob=publicationFile&v=4](https://www.bmwi.de/Redaktion/EN/Publikationen/Studien/sharing-economy-im-wirtschaftsraum-deutschland.pdf?__blob=publicationFile&v=4) (last visited Dec. 9, 2019) [hereinafter *Sharing Economy in Germany*]; Stefan Groß & Stefan Heinrichshofen, *“Share Economy” und die Frage nach der Umsatzsteuer* [“Share Economy” and the Questions of Sales Tax], 65 UMSATZSTEUERRUNDSCHAU [UR] 385 (2016).

intermediary.<sup>59</sup> If the service provider is a private person interacting with another private person it is called a ‘P2P-transaction’, which occurs outside of traditional business structures.<sup>60</sup> This type of transaction is very common in sharing economy business models.

Sharing platform operators create an online marketplace, bringing together providers with consumers. The platform operator charges a commission for providing the platform.<sup>61</sup> Thus, the platform business model consists of three main actors, the platform operator (e. g. Airbnb), the service provider (e. g. an accommodation host) and the service consumer (e. g. a guest). The concept can be categorized as follows the re-allocation of goods (‘redistribution markets’, e. g. eBay), the exchange of intangible assets (‘collaborative lifestyles’, e. g. Airbnb, TaskRabbit) and the access to products or services without need for owning the underlying assets (‘product-service systems’, e. g. Zipcar).<sup>62</sup> The sharing economy is growing rapidly. In 2015 the gross revenue in the European Union (EU) from sharing economy platforms and providers was doubled in comparison to the previous year and estimated to be 28 billion euros. Experts estimate the sharing economy could add up to 572 billion euros to the economy of the EU in the future. There is a high potential for new businesses to capture these fast-growing markets.<sup>63</sup>

The taxation challenges that arise in the context of transactions of platform users shall be exemplified by the accommodation (short-term leasing) sector. The facilitation of accommodation services in private homes was one of the earliest sharing economy markets.<sup>64</sup> One of the most prominent examples is Airbnb,<sup>65</sup> which operates as an intermediary platform that allows individuals to rent their homes,

<sup>59</sup> See *Sharing Economy in Germany*, *supra* note 58.

<sup>60</sup> See Katerina Pantazatou, *The Taxation of the Sharing Economy*, TAX AND THE DIGITAL ECON. 215, 216 (Werner Haslehner et al. ed., 2019).

<sup>61</sup> See RACHEL BOTSMAN & ROO ROGERS, WHAT’S MINE IS YOURS: HOW COLLABORATIVE CONSUMPTION IS CHANGING THE WAY WE LIVE 71 et seq. (2011); Burcin Bozdoganoglu, *Tax Issues Arise From a New Economic Model: Sharing Economy*, 2017 INT’L J. BUS. & SO. SCI. [IJBS] 119, 120; A *European Agenda for the Collaborative Economy*, COM(2016) 356 final, at 3 [hereinafter *COM(2016) 356 final*].

<sup>62</sup> See Botzman & Rogers, *supra* note 61; Bozdoganoglu, *supra* note 61.

<sup>63</sup> See *COM(2016) 356 final*, *supra* note 61, at 2; Beutin, *supra* note 56.

<sup>64</sup> See Official Norwegian Report (NOU) 2017:4 (hereinafter *Norwegian Report*) 9, [https://www.regjeringen.no/contentassets/1b21cafea73c4b45b63850bd83ba4fb4/en-gb/sved/nou\\_20174\\_chapter\\_1.pdf](https://www.regjeringen.no/contentassets/1b21cafea73c4b45b63850bd83ba4fb4/en-gb/sved/nou_20174_chapter_1.pdf).

<sup>65</sup> Airbnb, <https://www.airbnb.ie/>.

rooms or apartments.<sup>66</sup> Airbnb is also very successful in Germany.<sup>67</sup> ZEW<sup>68</sup> estimated the monthly revenue of Airbnb in Germany was at 57 million euros in 2018,<sup>69</sup> which results in an average annual turnover of Airbnb rentals in Germany of over 683 million euros in 2018.<sup>70</sup> In comparison, the revenue of common hotel groups in Germany was in 2018 as follows: Accor about 1,310 million euros, Best Western about 705 million euros, Steigenberger about 517 million euros and Hilton about 356 million euros.<sup>71</sup>

Although the activity of and on Airbnb is not illegal in the most cities, Airbnb faces increasing pressure from city or state authorities concerning many legal issues,<sup>72</sup> ranging from questions of taxation<sup>73</sup> to tenancy law,<sup>74</sup> consumer protection law,<sup>75</sup> building law<sup>76</sup> and

<sup>66</sup> See Rainer Bräutigam & Christopher Ludwig & Christoph Spengel, *Steuerlicher Reformbedarf bei Service-Plattformen: Eine Analyse anhand des deutschen Airbnb-Marktes* [Tax Reform Needs for Service Platforms: An Analysis Based on the German Airbnb Markets], 11, [http://ftp.zew.de/pub/zew-docs/gutachten/ZEW\\_Expertise\\_Airbnb\\_2019.pdf](http://ftp.zew.de/pub/zew-docs/gutachten/ZEW_Expertise_Airbnb_2019.pdf) (last visited Dec. 12, 2019); *Sharing Economy in Germany*, *supra* note 58, at 26.

<sup>67</sup> See Airbnb, *Airbnb-Jahresrückblick für 2017: Mehr als drei Millionen Gastankünfte in Deutschland* [Airbnb Annual Review for 2017: More Than Three Million Guests Arrivals in Germany], Dec. 19, 2017, <https://press.airbnb.com/de/airbnb-jahresueckblick-fuer-2017-mehr-als-drei-millionen-gastankuenfte-in-deutschland/> (last visited Dec. 12, 2019); Nick Lin-Hi, *Entwicklungsperspektiven der Sharing Economy: es ist nicht alles Gold was glänzt* [Development Perspectives of the Sharing Economy: Not All That Glitters Is Gold], in *DIGITALE WIRTSCHAFT UND SHARING ECONOMY. WIRTSCHAFTSETHISCHE UND MORALÖKONOMISCHE PERSPEKTIVEN* 145, 147 (Detlef Aufderheide & Martin Dobrowski ed., 2017); Beutin, *supra* note 56.

<sup>68</sup> ZEW (Leibniz Centre for European Economic Research in Mannheim, Germany, founded in 1990) is a member of the Leibniz Association and one of Germany's leading economy research institutes, see <https://www.zew.de/en/das-zew/ueber-das-zew/> (last visited Dec. 12, 2019).

<sup>69</sup> See Bräutigam et al., *supra* note 66, at 11.

<sup>70</sup> See Bräutigam et al., *supra* note 66, at 11.

<sup>71</sup> See AHGZ-Ranking 2019, <https://www.ahgz.de/shop/hotellerie/top-200-einzelhotels-deutschland-2018-940.html>.

<sup>72</sup> COM(2016) 356 final, *supra* note 61, at 3 et seq.; Bozdoganoglu, *supra* note 61; Simone Bueb, *Rechtsprobleme bei Privatvermietung von Wohnungen an Touristen* [Legal Problems with Privately Renting Apartments to Tourists], 17 ZEITSCHRIFT FÜR WOHNUNGSEIGENTUMSRECHT [ZWE] 207 et seq. (2016); Henke et al., *supra* note 57, at 1 et seq.; Markus Ludwigs, *Rechtsfragen der Sharing Economy am Beispiel der Modelle Uber und Airbnb* [Legal Issues of the Sharing Economy Using the Example of the Uber and Airbnb Models], 36 NEUE ZEITSCHRIFT FÜR VERWALTUNGSRECHT [NVWZ] 1646, 1650 et seq. (2017); Vanessa Mak, *Private Law Perspectives on Platform Services. Airbnb: Home Rentals between AYOR and NIMBY*, 5 J. EUR. CONSUMER & MKT. L. [EUCML] 19, 21 et seq. (2016); Solmecke & Lengersdorf, *supra* note 57, at 493-494.

<sup>73</sup> Udo Delp & Roland Ronig, *Sharing Economy, erweiterte Geschäftsmodelle und Besteuerung* [Sharing Economy, Expanded Business Models and Taxation] 2018 DB 1296 et seq.; Ivo Grlica, *How the Sharing Economy is Challenging the EU VAT System*, 28 IVM 124,125 (2017); Heinz Kußmaul & Florian Kloster, *Sharing Economy: Versteuerung der privaten Wohnraum(unter)vermietung im Zweifel?* [Sharing Economy: Taxation of Private Living Space Subletting in the Twilight?] 54 DSTR 1280 (2016).

<sup>74</sup> See, e.g., German tenancy law: LG Berlin (Regional Court of Berlin) of 03.02.2015 – 67 T 29/15, ECLI:DE:LGBE:2015:0203.67T29.15.0A; LG Berlin (Regional Court of Berlin) of 18.11.2014 – 67 S



regulatory law<sup>77</sup>. With regard to taxation, studies have shown that many landlords who place listings on sharing economy platforms did not declare their earnings and failed to pay the corresponding taxes.<sup>78</sup>

Since the activities on sharing economy platforms like Airbnb are (potentially) invisible to tax authorities, hosts may escape taxation of their income. This is one potential factor for the increasing popularity of sharing economy platforms: Due to the tax savings of the hosts they can offer lower prices, which makes the service of sharing economy platform particularly attractive to both the service provider side and the consumer side.<sup>79</sup> However, that has led to increased criticism of Airbnb<sup>80</sup> and led to complaints from unfair competition by businesses of the traditional economy that pay taxes such as hotels or bed & breakfast hostels.

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360/14, ECLI:DE:LGBE:2014:1118.67S360.14.0A; Bundesgerichtshof [BGH] [Federal Court of Justice] Feb. 29, 2012, NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 1647, 2012 (Ger.).

<sup>75</sup> Christoph Busch & Hans Schulte-Nölke & Aneta Wiewiórowska-Domagalska & Fryderyk Zoll, *The Rise of the Platform Economy: A New Challenge for EU Consumer Law*, 5 EUCML 3, 4 (2016); Evelyne Terryn, *The Sharing Economy in Belgium – A Case for Regulation*, 5 EUCML 45 et seq. (2016).

<sup>76</sup> Bueb, *supra* note 72, at 210; Albert Ingold, *Die „Sharing Economy“ der kurzzeitigen Unterkunftsvermietung als Herausforderung für das Gewerbe-, Bau- und Ordnungsrecht* [The “Sharing Economy” of Short-Term Rental as a Challenge for Commercial, Construction and Regulatory Law], 2016 DÖV 595 et seq.; Ludwigs, *supra* note 72, at 1651; Meinhard Schröder, *Bau- und ordnungsrechtliche Fragen der kurzzeitigen Wohnraumvermietung über Internetportale im Rahmen der Sharing Economy* [Construction and Regulatory Issues of Short-Term Renting via Internet in the Context of the Sharing Economy], 2015 GewA 392 et seq.; Alexander Windoffer, *Wider die Zweckentfremdung – Ordnungsrechtliche Grenzen der „Sharing Economy“ bei kurzfristigen Vermietungen* [Against Misuse – Regulatory Limits of the “Sharing Economy” for Short-Term Rentals], 26 LANDES- UND KOMMUNALVERWALTUNG [LKV] 337, 339 et seq. (2016).

<sup>77</sup> Bueb, *supra* note 72, at 210; Frank Hinrichs, *Nebenwohnungen und Zweckentfremdungsverbot in Hamburg* [Side Apartments and Misuse in Hamburg], 20 NZM 589 et seq. (2017); Ludwigs, *supra* note 72, at 1652; Windoffer, *supra* note 76, at 341.

<sup>78</sup> Bräutigam et al., *supra* note 66.

<sup>79</sup> Pantazatou, *supra* note 60, at 225.

<sup>80</sup> Jonas Fehling, *Airbnb, was ist das? Deutsche Finanzämter verschlafen Millionen-Einnahmen*, Focus [Airbnb, What Is It? German Tax Offices Lost Millions of Dollars in Revenue], Oct. 22, 2013, [https://www.focus.de/finanzen/steuern/tid-34247/us-behoerden-jagen-schon-private-vermieter-airbnb-was-ist-das-deutsche-finanzaemter-verschlafen-millioneneinnahmen\\_aid\\_1136297.html](https://www.focus.de/finanzen/steuern/tid-34247/us-behoerden-jagen-schon-private-vermieter-airbnb-was-ist-das-deutsche-finanzaemter-verschlafen-millioneneinnahmen_aid_1136297.html); Otto Fricke & Carsten Linnemann, *Die richtige Steuer für Airbnb & Co.* [The Right Tax for Airbnb & Co.], FOCUS, Jun. 2018, at 25; Christian Ramthun & Benedikt Becker & Rüdiger Kiani-Kreß & Volker ter Haseborg, *Jagd auf Airbnb* [Hunting on Airbnb], WIRTSCHAFTSWOCHEN, May 4, 2018, at 28; Peter Talaska & Oliver Cremers, *Auskunftsersuchen an „Airbnb“: Sind Selbstanzeigen noch möglich?* [Requests for Information to “Airbnb”: Are Voluntary Reports Still Possible?], 71 DER BETRIEB [DB] 1824, 1825 (2018); Götttrik Wewer, *Faire Chancen für die kollaborative Wirtschaft? Neue Agenda der EU-Kommission* [For the Collaborative Economy? New Agenda of the EU Commission], 49 ZEITSCHRIFT FÜR RECHTSPOLITIK [ZRP] 193, 196 (2016).

It should also be noted, however, that the sharing economy also shows tremendous benefits: Its business models have a significant potential to contribute to competitiveness and growth. For consumers, the sharing economy can provide new services, an extended supply, and lower prices. It can also encourage more asset-sharing and more efficient use of resources, which can contribute to the protection of the environment.<sup>81</sup> Thus, the sharing economy should be supported and developed in a responsible manner.<sup>82</sup> For this purpose, tax systems must be modified and targeted on the digital economy.<sup>83</sup> Consequently, the aim of this part of the paper is to develop proposals to reform the direct taxation of the sharing economy transactions, illustrated by the example of Airbnb.

### *B. Taxation Challenges of Provider Transactions*

#### *1. Sharing Platforms and Contractual Relations*

The Airbnb platform model works as follows: Airbnb operates as an intermediary online platform that allows registered individuals to rent out their homes, rooms or apartments, while Airbnb handles the entire payment process. The tenant transfers the rent to Airbnb, and Airbnb charges a service fee based on the rent and transfers the remaining amount to the host.<sup>84</sup> The special feature of the platform model is that the platform operator carries out the payment transactions and thus controls the transaction data as well as the payment flow.

This requires three legal relationships: The first contractual relationship is between the platform operator Airbnb and the host who offers its real estate through the platform. This contractual relationship constitutes the right of the host to use the platform for offering his apartment and obliges him to pay a fee to Airbnb in the event of letting the apartment to guests. The second contractual relationship is between Airbnb and the guests and enables the guests to use the platform and book accommodations. The host and the

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<sup>81</sup> See COM(2016) 356 final, *supra* note 61, at 2; Grlica, *supra* note 73.

<sup>82</sup> See COM(2016) 356 final, *supra* note 61, at 2; Lin-Hi, *supra* note 67; Beutin, *supra* note 56; Talaska & Cremers, *supra* note 80, at 1824.

<sup>83</sup> See COM(2016) 356 final, *supra* note 61, at 2, 15.

<sup>84</sup> See Ludwigs, *supra* note 72, at 1650; Mak, *supra* note 72, at 20.

guest are the parties of the third contract, which comprises the rental agreement.

## 2. Challenges for the Income Taxation of Users of a Sharing Platform

In general, sharing economy transactions can be compared to conventional activities and characterized within the existing tax principles of a country.<sup>85</sup> According to German tax law as to the most other jurisdictions, a host of Airbnb is subject to income tax on her income earned at Airbnb, even in case of sharing her own home in return for remuneration.<sup>86</sup> Nevertheless, many hosts do not tax their earnings and tax authorities fail in collecting taxes. The damage caused to the tax revenue because of non-compliance of Airbnb hosts is estimated to be huge.<sup>87</sup> But not only the treasury is being harmed, also the principle of tax neutrality is threatened<sup>88</sup> since non-compliant (and undetected) online providers get a tax advantage compared to traditional providers due to a lack of tax enforcement. In order to avoid such distortions of competition, a level playing field for all market participants is required that also comprises an equal enforcement of tax laws.<sup>89</sup>

For the establishment of such an adequate framework, first, it is important to identify the reasons for tax evasion in the sharing economy. The main reason for revenue loss created by sharing economy activities via Airbnb is not that the existing substantive tax would be insufficient.<sup>90</sup> The transactions of hosts via Airbnb are subject to income tax and the applicable laws are clear for the most

<sup>85</sup> See Nangel Kwong, *The Taxation of 'Sharing Economy' Activities*, TAXATION IN A GLOBAL DIGITAL ECONOMY 61, 64 (Ina Kerschner & Maryte Somare ed., 2017); For specific tax rules regarding the sharing economy see Part II, section 3 a).

<sup>86</sup> See Bueb, *supra* note 72, at 211; Kußmaul & Kloster, *supra* note 73, at 1282 et. seq.

<sup>87</sup> See Bräutigam et al., *supra* note 66; COM(2016) 356 final, *supra* note 61, at 13; Jonas Fehling, *supra* note 80; Fricke & Linnemann, *supra* note 80; Ramthun et al., *supra* note 80 at 28; Talaska & Cremers, *supra* note 80; Wewer, *supra* note 80.

<sup>88</sup> See Federal Constitutional Court of 27.06.1991 – 2 BvR 1493/89, 84 BVerfGE 239; THOMAS FETZER, DIE BESTEUERUNG DES ELECTRONIC COMMERCE IM INTERNET [THE TAXATION OF ELECTRONIC COMMERCE ON THE INTERNET] 211 et seq. (2000).

<sup>89</sup> *Sharing Economy in Germany*, *supra* note 58, at 90-91.

<sup>90</sup> Carrie Brandon Elliot, *International Taxation of the Sharing Economy: Recurring Issues*, 72 BIT No. 4a/Special Issue (2018), available at [https://www.ibfd.org/IBFD-Products/Journal-Articles/Bulletin-for-International-Taxation/collections/bit/html/bit\\_2018\\_4a\\_int\\_7.html](https://www.ibfd.org/IBFD-Products/Journal-Articles/Bulletin-for-International-Taxation/collections/bit/html/bit_2018_4a_int_7.html).

part.<sup>91</sup> The key issue is the lack of tax compliance and tax enforcement.<sup>92</sup> The first reason for that might be that service providers in the sharing economy are to large extent private individuals, who may have little knowledge of the tax rules and limited experience of involvement in commercial activity.<sup>93</sup> Secondly, activities in the sharing economy generate small incomes from numerous private individuals, who may be active in several markets simultaneously and who may start and drop activities relative frequently.<sup>94</sup> However, the most challenging problem is the lack of visibility of the provider's activity.<sup>95</sup> National tax authorities do not necessarily know whether a person rents out his apartment for some days per year.<sup>96</sup> In Germany, for example, tax authorities only check the intended use of an apartment at the time of purchase. Subleases are not visible to the authorities, in principle. Furthermore, it is very difficult to identify taxpayers due to the sheer volume of low-value transactions and the fact that many transactions are conducted between providers and private consumers aggravates the amount of information that needs to be collected.<sup>97</sup> Tax authorities are essentially dependent on the landlords declaring their income or the platform operator must provide the data.<sup>98</sup> Collecting data from the platform operator was already practiced by a request of German authorities to Airbnb Dublin in May 2018.<sup>99</sup> But the practical effect of this method is limited. The process is very time-consuming and covers only occasional transactions. Future transactions require new requests for information, so that this procedure cannot sufficiently contribute to equal taxation. However, since platform operators have the required information, reforms should focus on them.

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<sup>91</sup> Bueb, *supra* note 72, at 211; Kußmaul & Kloster, *supra* note 73, at 1282 et seq.

<sup>92</sup> COM(2016) 356 final, *supra* note 61, at 14; *Sharing Economy in Germany*, *supra* note 58, at 6; Grlica, *supra* note 73; Pantazatou, *supra* note 60, at 231.

<sup>93</sup> Grlica, *supra* note 73.

<sup>94</sup> *Norwegian Report*, *supra* note 64, at 10.

<sup>95</sup> Elliot, *supra* note 90.

<sup>96</sup> Pantazatou, *supra* note 60, at 225.

<sup>97</sup> Grlica, *supra* note 73.

<sup>98</sup> Pantazatou, *supra* note 60, at 225.

<sup>99</sup> See *Finanzbehörden nehmen Airbnb-Vermieter unter die Lupe* [Tax Authorities Scrutinize Airbnb Landlords], FAZ, May 04, 2018, <http://www.faz.net/aktuell/finanzen/meine-finanzen/steuern-sparenfinanzbehoerden-nehmen-airbnb-vermieter-wegen-verdacht-auf-steuerhinterziehung-unter-die-lupe-15573894.html> (last visited Dec. 12, 2019); Ramthun et al., *supra* note 80.

### *C. Proposals to Secure Tax Collection of Transactions on Airbnb*

The European Commission is convinced that countries can improve tax collection by collaborating with platform operators which already record digital transactions via their platforms.<sup>100</sup> One factor of digital business models that can be taken advantage of for reforming models regarding the sharing economy is the generally increased traceability of transactions due to the rise of data.<sup>101</sup> As the sharing economy and its economic arrangements are relatively uniform and there are not many major players, enforcement measures should therefore involve the platform operator. At the platform operator's level there are three different ways to contribute to better enforcement and collection of taxes: Information on the platform of tax obligations and support in fulfilling them through automated compliance processes; storage and transmission of service providers' data; direct collection and payment of taxes by the platform operator.<sup>102</sup>

#### *1. Existing Reforms*

Several cities have already implemented such reforms in order to effectively tax transactions performed through sharing platforms. Those proposals can be divided in three groups: informative measures, data control systems and the obligation of the platform operator to collect taxes.

An example for an informative measure has been implemented in Estonia with regard to ride-sharing platforms. To simplify the tax declaration process for drivers, transactions between drivers and customers are registered by the platform provider which sends the relevant data to the authorities, pre-filling taxpayers' tax forms.<sup>103</sup>

Data control system obliges platform operators to keep relevant information regarding transactions performed through the platform users and to transfer the data to tax authorities.

A tax system which obliges the platform operator to collect and pay taxes on behalf of the taxpayer is called withholding tax system.

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<sup>100</sup> See COM(2016) 356 final, *supra* note 61, at 14.

<sup>101</sup> See COM(2016) 356 final, *supra* note 61, at 14.

<sup>102</sup> See Pantazatou, *supra* note 60, at 225.

<sup>103</sup> See Pantazatou, *supra* note 60, at 225; COM(2016) 356 final, *supra* note 61, at 14.

A withholding tax is a special form of income tax collection.<sup>104</sup> Whereas usually the recipient of taxable income has to pay income tax on that income a withholding tax shifts that responsibility to the payer of the compensation.<sup>105</sup> Measures regarding tax collection obligations of the platform operator on behalf of state authorities vary in their design. One existing example of a cooperation is tax collecting agreements between Airbnb and various local tax authorities around the world.<sup>106</sup> According to these agreements, Airbnb collects tourist taxes or occupancy taxes on behalf of the host and remits it directly to the respective tax authority.<sup>107</sup> In France, new laws even made it mandatory for platform operators to collect and remit tourist taxes from January 2019.<sup>108</sup> Italy implemented a general framework tailored to the sharing economy, which states that annual income up to an amount of 10,000 euros earned will be subject to a tax at a rate of 10%. The tax will be withheld at source by the platform operator and transferred to the tax authorities.<sup>109</sup> Similarly, Belgium implemented a withholding tax on income up to an amount of 5,000 euros per year. It will be taxed at a rate of 20% after a deduction of a 50% allowance, which results in fact in an effective tax rate of 10%.<sup>110</sup>

<sup>104</sup> See Federal Ministry of Finance, *An ABC of Taxes*, 81 (2016), [https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Press\\_Room/Publications/Brochures/2012-10-30-abc-on-taxes-pdf.pdf?\\_\\_blob=publicationFile&v=17](https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Press_Room/Publications/Brochures/2012-10-30-abc-on-taxes-pdf.pdf?__blob=publicationFile&v=17) (last visited Dec. 12, 2019).

<sup>105</sup> *Id.* at 133.

<sup>106</sup> See *Sharing Economy in Germany*, *supra* note 58, at 119; Solmecke & Lengersdorf, *supra* note 57, at 493 et seq.; BRAD STONE, *DIE SHARING-ECONOMY: TEILE UND HERRSCHE. WIE ÜBER UND AIRBNB GANZE INDUSTRIEN UMKREMPeln* [THE SHARING ECONOMY: COMPONENTS AND RULES. HOW UBER AND AIRBNB TAKE UP WHOLE INDUSTRIES] 298 (2017).

<sup>107</sup> See Airbnb, *Hosting Help: In What Areas Is Occupancy Tax Collection and Remittance by Airbnb Available?* [https://www.airbnb.ie/help/article/2509/in-what-areas-is-occupancy-tax-collection-and-remit-tance-by-airbnb-available?\\_set\\_beve\\_on\\_new\\_domain=1528102327\\_kNEtV2POf2uawWaX](https://www.airbnb.ie/help/article/2509/in-what-areas-is-occupancy-tax-collection-and-remit-tance-by-airbnb-available?_set_beve_on_new_domain=1528102327_kNEtV2POf2uawWaX) (last visited Dec. 12, 2019).

<sup>108</sup> See Bal, *supra* note 56.

<sup>109</sup> See Bozdoganoglu, *supra* note 61. Revenues over the amount of 10,000 euros are subject to the rates applied to the professional income of service providers.

<sup>110</sup> See *Sharing Economy wird ab Mittwoch in Belgien besteuert* [Sharing Economy Will Be Taxed in Belgium from Wednesday], BRF, (Mar. 03, 2017), <https://brf.be/national/1067171/>; Alexander De Croo, *Belgian Government Approves Simple and Low Tax Rates for Sharing Economy*, (Jun. 06, 2016), <https://www.decroo.belgium.be/en/belgian-government-approves-simple-and-low-tax-rates-sharing-economy>; Marc Quaghebeur, *Belgium Introduces a Tax Regime for the Sharing Economy*, (Jul. 08, 2016), <http://www.dvp-law.com/documents/news-items/20160708-belgium-introduces-a-tax-regime-for-the-sharing-economy-.xml>.

## 2. Assessment of the Reforms

### *(a) Informative Measures*

The first reform proposal contains simplifications in the tax declaration process as exemplified in the case of Estonia. Information tools, tax declaration assistance or automated prepared tax declarations on or through the platform shall facilitate the service providers' tax compliance.<sup>111</sup> As the European Commission suggests in its communication on the collaborative economy '[raising] awareness on tax obligations [...], issuing guidance, and increasing transparency through online information' are possible ways of ensuring a level playing field without hindering the growth of the sharing economy.<sup>112</sup> It is probably true that these informative measures promote tax compliance. But these measures alone will not guarantee proper tax collection since they do not secure taxpayers' compliance declaring their income achieved from sharing economy platforms. Therefore, reforms linked to mere informational measures alone are not sufficient.

### *(b) Data Collecting System*

The second approach is obliging platform operators to report the data they obtain from transactions. With that information tax authorities can check the tax records of service providers which will support tax compliance since taxable persons may fear the risk of being detected.<sup>113</sup> However, getting data when the platform operator is located in a third country becomes extremely difficult, since national law cannot be enforced easily in a third country. Hence, in order to enforce the platform operators' obligation of transferring data, this obligation would have to be supplemented by liability obligation in order to be more effective.

### *(c) Withholding Tax System*

The third proposal suggests an obligation for the platform operator to collect taxes on behalf of the service providers.<sup>114</sup> Airbnb would have to withhold the taxes in the course of the payment

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<sup>111</sup> See Pantazatou, *supra* note 60, at 231.

<sup>112</sup> See COM(2016) 356 final, *supra* note 61, at 13.

<sup>113</sup> Bozdoganoglu, *supra* note 61, at 125.

<sup>114</sup> See *Sharing Economy in Germany*, *supra* note 58, at 16; Fricke & Linnemann, *supra* note 80.

process and transfer them to the local authorities for the landlords' accounts.<sup>115</sup> This reform model seems most promising where data are centralized at the platform like in the case of Airbnb. When users register with Airbnb, Airbnb already requests personal data from the service provider, which could be extended to include the tax identification number.<sup>116</sup> The tax identification number is necessary for a withholding tax system so that the tax authorities can allocate the withheld tax and its underlying transactions. The transactions carried out are already followed by the platform operator under the current system as part of the booking process, since a brokerage commission is retained. On this basis, a fixed tax rate could then be charged at a fixed rate on the rental price and transferred to the tax authorities. Such a tax would not be totally new since in many jurisdictions a withholding tax at source is applied to dependent employment or income from capital assets. The huge advantages of a withholding tax are an increasing tax compliance of service providers (theoretically up to 100 %), and a reduction of the administrative burden for tax authorities.

Since such a withholding tax, however, increases the administrative burden for platform operators the question arises as to whether that increase can be justified.

#### (i) Justification for the Introduction of a Withholding Obligation for Platform Operators

The implementation of an automated tax withholding system will cause administrative costs to the platform operator,<sup>117</sup> which under German law as well as EU law affects the platform operator in its fundamental rights, such as the freedom of profession.<sup>118</sup> Therefore, it is questionable whether the integration of platform operators into the tax enforcement system is legal and can be justified. The

<sup>115</sup> See Klaus-Dieter Dr  n, *Grenzen der Steuerentrichtungspflichten – Verfassungsrechtliche Bestandsaufnahme angesichts intensivierter Arbeitgeberpflichten beim Lohnsteuerabzug* [Limits of Tax Payment Obligations - Constitutional Inventory in View of Intensified Employer Obligations with Regard to Wage tax Deduction], 86 FR 1134 (2004); *Sharing Economy in Germany*, *supra* note 58, at 6.

<sup>116</sup> See Fricke & Linnemann, *supra* note 80.

<sup>117</sup> See Pantazatou, *supra* note 60, at 223.

<sup>118</sup> Johanna Hey, *Mitteilungspflichten oder Quellenabzug – Ma  nahmen zur Sicherung von Steueranspr  chen* [Communication Obligations or Withdrawals: Measures to Secure Tax Claims], Festschrift f  r Heinrich Wilhelm Kruse zum 70. Geburtstag 269, 287 (Walter Drenseck & Roman Seer ed., 2001).



integration might be justified by equal taxation. Fair taxation is a legitimate purpose.<sup>119</sup> Furthermore, possible considerable justifications are conservation of resources to protect the environment, the social idea of sharing and the reduction of administrative costs.<sup>120</sup> But the involvement of platform operators for governmental functions as tax collection must also be reasonable to achieve these aims. This is the case, if the platform operator must show some responsibility for the tax issues that arise with regard to sharing economy transactions.<sup>121</sup> The platform operator enables transactions to be carried out easily and anonymously by providing the platform and it contracts with the dishonest hosts at the first stage of the procedure. However, it should also be noted that the platform operator is only an intermediary which offers a 'neutral' infrastructure contribution similar to that of postal and telephone operators, market operators or logistics providers in the analog world.<sup>122</sup> Thus, on one hand, the operators of digital markets make an inevitable contribution to the development of the infrastructure on the internet and carry out socially desirable actions.<sup>123</sup> On the other hand, platform operators enable tax evasion. However, the integration of the platform operator can be justified because it is placed in a better position compared to the tax authorities since it has the control of the payment transactions and the information which is

<sup>119</sup> BFH (Federal Fiscal Court) of 05.07.1963 – VI 270/62 U, 77 BFHE 408; Federal Constitutional Court of 29.11.1967 – 1 BvR 175/66, 22 BVerfGE 380, 383 et seq.; Drüen, *supra* note 115, at 278 et seq.; Bernd Heuermann, *Entrichtungspflicht – Steuerpflicht – Grundpflicht?* [Payment Obligation, Tax Liability, Basic Obligation?], 95 FR 354, 358 (2013); Hey, *supra* note 118, at 278; GREGOR KIRCHHOF, *DIE ERFÜLLUNGSPFLICHTEN DES ARBEITGEBERS IM LOHNSTEUERVERFAHREN* [THE EMPLOYER'S OBLIGATION TO COMPLY WITH THE INCOME TAX PROCEDURE] 72 et seq. (2005); Günter Krohn, *Zulässigkeit und Grenzen der Überwälzung von Steuerabführungspflichten auf private Unternehmer* [Eligibility and Limits of the Transfer of Tax Deduction Obligations to Private entrepreneurs], 24 BB 1233, 1236 (1969).

<sup>120</sup> Solmecke & Lengersdorf, *supra* note 57, at 497.

<sup>121</sup> Federal Constitutional Court of 22.01.1997 – 2 BvR 1915/91, 95 BVerfGE 173, 187; of 02.03.2010 – 1 BvR 256/08, ECLI:DE:BVerfG:2010:rs20100302.1bvr025608; Drüen, *supra* note 115, at 291 et seq.; Ulrich Hufeld, *Betreiberhaftung im Internethandel: Gutachten zu § 22f, 25e UStG – neu – im Entwurf eines Gesetzes zur Vermeidung von Umsatzsteuerausfällen beim Handel mit Waren im Internet und zur Änderung weiterer steuerlicher Vorschriften vom 1.8.2018* [Operator Liability in Internet Business: Expert Opinion on § 22f, 25e UStG - New in the Draft to Avoid Sales Tax Losses When Trading Goods on the Internet and to Change Other Tax Regulations from 1.8.2018], 2018 DEUTSCHE STEUER-ZEITUNG [DSTZ] 755, 760 et seq. (2018).

<sup>122</sup> Hufeld, *supra* note 121, at 763; Ansgar Ohly, *Die Verantwortlichkeit von Intermediären* [Responsibility of Intermediaries], 59 ZEITSCHRIFT FÜR URHEBER- UND MEDIENRECHT [ZUM] 308, 311 (2015).

<sup>123</sup> Ohly, *supra* note 122, at 308.

needed for proper taxation.<sup>124</sup> Thus, the withholding tax falls within its sphere of influence.

Moreover, the effort which is necessary on part of platform operators has to be evaluated as low. The platform operator has already most of the required data since the operator carries out the booking process. It must keep records for its own taxation anyway. Missing data could be requested easily and automatized during the registration process. The tax deduction could be integrated to the system which handles the fee for Airbnb. With the collection of the tourism tax this procedure is already practiced by Airbnb. In addition, this reform model is also beneficial for platform operators: The tax gaps caused by hosts led to many criticisms on the platform model of Airbnb. This criticism could be eliminated with the withholding tax.

#### (ii) Justification for a Tax Prepayment Obligation

Nonetheless, the withholding tax gives also causes for concern with regard to its effects on the taxable hosts. In the case of withholding tax, the tax is already due when the transactions are carried out. As a result, withholding taxes have an advance payment character. It is, therefore, necessary to strike an appropriate balance between the amount of the withholding tax and the actual tax liability.<sup>125</sup> As a collection technique, the deduction at source can therefore only be adequate if the ratio between income and taxable income is relatively constant, so that it is possible to calculate the withholding tax on the basis of income without having to fear over-collateralization.<sup>126</sup> In the case of income from rents via Airbnb, this will regularly be less problematic, since usually no significant expenses can be deducted or these expenses can be considered already with the calculation on Airbnb within the course of the booking procedure.

After all, a withholding tax (also named deduction tax at source) which obliges the platform operator to collect and transfer a tax on behalf of service providers is the most efficient reform proposal for

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<sup>124</sup> Carsten Brodersen, *Haftung und Schuld im Steuerrecht [Liability and Debt in Tax Law]*, Festschrift für Werner Thieme zum 70. Geburtstag, 895, 898 (Bernd Becker & Hans Peter Bull & Otfried Seewald ed., 1993); Drüen, *supra* note 115, at 292 et seq.; Hufeld, *supra* note 121, at 765.

<sup>125</sup> Hey, *supra* note 118, at 284.

<sup>126</sup> Hey, *supra* note 118, at 284.

the taxation of the sharing economy. Outsourcing this enforcement and collection function to the platforms ensure (theoretically) full tax compliance. The platform operators of the sharing economy are best placed to ensure compliance with the rules by their users and are ideally positioned to ensure enforcement of service providers' legal obligations since all the information is already centralized on the platform.<sup>127</sup> A tax deduction at source or withholding tax system is, therefore, one of the most effective instruments for securing tax compliance<sup>128</sup> and also the most effective way to avoid tax evasion of the Airbnb hosts.

### III. SUMMARY

Digitalization has given rise to a tremendous number of cross-border online transactions. However, income of these digital business models is not necessarily taxed in the country in which a digital service has been used. This is why the current rules on international taxation are criticized for being outdated. The reform proposals of the EU are based on two ideas: The first concept is the introduction of a new digital services tax at the rate of 3 %. The second proposal suggests a modification of the nexus for taxation: Instead of the existence of a physical presence (permanent establishment) a new nexus shall be introduced: a significant digital presence. The assessment of both proposals has shown that none of them can solve the taxation problem adequately. The digital services tax bears the risk of a patchwork of tax rules, treaty overrides, double taxation and unprofitable cost expenditures. The modification of the nexus that includes a digital presence besides a physical one needs precise definitions and clear differentiation criteria to distinguish digital and traditional business transactions. To avoid double taxation, any reform must be based on an international consensus.

<sup>127</sup> See Fricke & Linnemann, *supra* note 80; Hey, *supra* note 118, at 278; Pantazatou, *supra* note 60, at 224; Solmecke & Lengersdorf, *supra* note 57, at 497; KLAUS TIPKE, DIE STEUERRECHTSORDNUNG. BAND III. STEUERWISSENSCHAFT, STEUERGESETZGEBUNG, STEUERVOLLZUG, STEUERRECHTSSCHUTZ, STEUERREFORMBESTREBUNGEN [THE TAX REGULATION VOLUME III. TAX SCIENCE, TAX LEGISLATION, TAX IMPLEMENTATION, TAX LAW PROTECTION, TAX REFORM MEASURES] 1465 (2nd ed. 2012).

<sup>128</sup> See, e. g., Federal Constitutional Court of 27.06.1991 – 2 BvR 1493/89, 84 BVerfGE 239, 281 et seq.; of 10.04.1997 – 2 BvL 77/92, 96 BVerfGE 1, 8; of 09.03.2004 – 2 BvL 17/02, ECLI:DE:BVerfG:2004:ls20040309.2bv1001702; Hey, *supra* note 118, at 278 et seq.; Heuermann, *supra* note 119.

Another challenge for taxation arises especially in the sharing economy is that the anonymity of the internet combined with an increased activity of private individuals on sharing economy platforms makes it difficult for the tax authorities to identify taxable transactions. The introduction of a withholding tax could be an important starting point to avoid tax evasion not only for accommodation platforms but also in the context of other sharing economy platforms. Introducing an automated withholding tax system could guarantee an effective and equal taxation of the income of users of the sharing economy. Digital technologies, therefore, not only pose new challenges to taxation but also provide new tools for enforcing tax.