IS DIGITAL TAX IMPOSED BY SOURCE COUNTRIES ON NON-RESIDENT DIGITAL BUSINESS INCOME JUSTIFIED?

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INTRODUCTION

'In this world nothing can be certain, except death and *taxes*.'[1]

Globalisation is a fixture in the fibric of nations, and has driven cross-border digital businesses to reach customers world-wide. Moreover, the CVID19 pandemic, with its attendant lockdowns, also catalysed socio-economic digital interactions.[2] Digital platforms have, consequently, acquired users in different jurisdictions to advance their digital businesses.

Through varied business models, multinational digital businesses have obtained vast wealth,[3] and over the years have enjoyed automatic tax exemption in market jurisdictions since they do not posses any physical presence - permanent eestablishment (PE) - in the market jurisdictions, as law requires.[4]

To address this tax gap, and curtail unilateral actions by states, the United Nations, and the Organisation for Economic Co-operation and Development (OECD) developed a bilateral tax treaty model, and multilateral tax convention framework respectively, but both instruments do not constitute binding treaties; while the former is a limited optional model, the latter is not in force. Consequently, some states including the UK, Canada, France, and India have implemented digital tax - digital services tax (DST) – on cross-border business income sourced

[1] Benjamin-Franklin (1789), in a letter to Jean-Baptist Leroy. Emphasis added.

[2] Cebreiro-Gómez, A. *etal* (2021), Digital Services Tax: Country Practice and Technical Challenges, Macroecomics, Trade & Investment, World Bank Group, p9; https://documents1.worldbank.org/curated/en/

[3] Ibid

[4] Article 7 of OECD, and UN Tax Treaty Models; See also Arnold J. (2023) International Tax Primer, Fifth Edition,
Kluwer Law International B.V. pages 27 and 29; and Erasmus N. (2018) Zimmer Ltd v Germany: Implications for International Taxation and Transfer Pricing. Available at https://www.taxriskmanagement.com/zimmer-ltd-vs-germany-2018-case-analysis/

from their jurisdictions.[5] To what extent is this digital tax on cross-border business income justified?

This paper will examine the extent to which digital tax on cross-border income of non-resident digital businesses is justified. The paper will undertake this task by exploring the positive reasons source countries impose the tax, and the rationales which render the tax unreasonable. It will conclude that taxing cross-border digital income is justified given its superior reasons; however, a binding multilateral treaty is the best approach to implement the tax.

JUSTIFICATION FOR DIGITAL TAX

Varied reasons undergird source nations' introduction of digital tax:

Source nations' imposition of digital tax on income of non-resident online businesses creates horizontal equity in their tax system. It levels the playing field between the domestic businesses and foreign enterprises. While domestic brick-and-mortar enterprises such as supermarkets and marts businesses pay taxes on their profits foreign entities like Amazon, Ali Express, Temu, and Facebook who engage in equivalent business online, pay no taxes to the source jurisdictions. Such horizontal inequity grants the online businesses unfair advantage and renders the resident businesses less competitive. Therefore, the digital tax cures that mischief and institutionalises fair competition, and horizontal equity in the tax system.

Digital tax can be a measure to inject fiscal fairness into the digital economy, and ensure that multinationals pay their fair share, or compensatory tax to market countries.[6] Some resident entities engage in digital business to target domestic customers. These resident online businesses operate with the non-resident digital businesses in the same digital space. Ironically, while the resident businesses pay taxes on their income, because of their residence status, the non-residents do not pay any income tax to the source jurisdictions. Giants such as Meta,

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[5] UK Government's Policy Paper on Digital Services Tax, published 11th March 2020, at http//www.gov.uk Dove N. (2024), Canada's Digital Services Tax is here. How could it affect you? Global News https://globalnews.ca/news/10604912/digital-services-tax/; France's Digital Tax Policy, Information Technology and Innovation Foundation, updated February 27, 2025, at ttps://itif.org/publications/2025/02/11/france-digital-tax-policy; India's Digital Tax Policy Information Technology and Innovation Foundation, updated February 27, 2025, at https://itif.org/publications/2025/02/11/india-digital-tax-policy/

[6] Schön, W. (2017) Ten Questions about Why and How to Tax the Digitalised Economy, p10, at http://www. http://www.tax.mpg.de

Google, Apple, Microsoft, and Amazon benefit from this unequal system. This disparity creates tax injustice in the digital economy, and digital tax conduces balance in that regard.

Although foreign digital businesses may have no physical presence in some source jurisdictions they do, by virtue of their online businesses, have economic presence in source countries. Indeed, their consistent localised online advertising, user-size, network effects, and revenue from residents, may constitute significant economic presence which create a requisite nexus to source jurisdictions.[7] When a certain scale of economic activity exists, based on country specific thresholds, a taxing right ensues that should enable source jurisdictions to impose digital tax on the income sourced from those jurisdictions. Moreover, since taxes are by nature economic a significant digital economic presence should, arguably, constitute a justifiable basis for tax than a mere physical presence with less economic activity. The sustained economic interaction with residents creates what is known as 'Virtual PE' which underpin digital service taxes in nations such as Indonesia, Nigeria, Israel,[8] and India.

Another justification for digital tax is to conceive it as a location-specific rent tax. We Cui (2018)[9] espouses this justification by using the Airbnb business model, and argues that the jurisdictions where the hosts' properties situate generate the rents that the renters pay. Consequently, those jurisdictions have taxing right on the portion of revenue that Airbnb earns from each specific rental transaction on properties in the said jurisdictions. This principle is extendable to multisided platforms such as Facebook and Google: These platforms earn income from advertisement; therefore, the jurisdictions where the consumers, the real target of the advertisements, are located have taxing right on the share of the advertising income attributable to those jurisdictions. The platforms, also, commercially exploit user data. Consequently, countries whose residents' data the online businesses commercialise are entitled to tax the income that accrue from that exploitation.

There is no gainsaying that digital tax on non-resident online businesses is extraterritorial in nature, and may offend the sensibilities of host countries. However, the international competition law principle, 'qualified effect', may ground a justification for the tax. The principle stipulates that if a foreign entity's conduct abroad produces substantial, immediate,

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[7] Ibid p19

[8] Cebreiro-Gómez, op.cit pp11 and 17

[9] We Cui (2018), The Digital Services Tax: A Conceptual Defense, Proceedings. Annual Conference on Taxation
and Minutes of the Annual Meeting of the National Tax Association, Vol. 111 (2018), pp. 1-28 (28 pages) https://www.jstor.org/stable/26939396

and foreseeable effect in the EU market the EU would assume jurisdiction and determine liability under EU competition law.[10] The U.S shares an equivalent principle.[11] In application, where a non-resident digital business acquires a significant user base and/or income, based on country-specific threshold, that business may be said to have produced qualified effect in the source country for tax liability purposes, thereby engaging the digital tax.

Dedicated digital tax on income sourced from market jurisdictions constitutes a proxy for corporate income tax. This is justified on grounds that by international custom the source country has the primary right to tax the income of the foreign undertaking while the resident country has the secondary tax right, and the obligation to obviate any incidence of double taxation.[12] Therefore, the absence of a physical presence should not, absent a treaty provision to the contrary, deprive a source country from imposing a tax, directly or indirectly, on the business income of non-residents sourced from its jurisdiction.

Governments invest in broadband infrastructure to enable their residents have access to internet. For example, the UK government in 2023 invested GBP1.3 billion to boost broadband connectivity to more than 380,000 homes and businesses in the country.[13] That investment was to ensure that hard-to-reach homes had access to fast internet.[14] several nations also invest in cybersecurity. They commit national resources to prevent and combat cybercrime to protect online activities in their jurisdictions. They even collaborate with international cyber protection units to ensure safe browsing. IDC Data Analytics estimated global spending on cybersecurity to top USD219 billion in 2023.[15] These investments deserve returns, and the infrastructure also require maintenance. In accordance with the benefit principle, non-resident businesses that benefit from these national investments ought to contribute to the investing jurisdictions, and digital tax provides the avenue for that contribution.[16]

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[10] Intel Corporation v, Commission Case C-413/14, judgment of the court dated 6th September 2017.
[11] Subsection 1(A) of the Foreign Trade Antitrust Improvement Act (FTAIA)
[12] Arnold, op.cit, p26
[13] From Fields to Fibres: UK Government invests £1.3 Billion into broadband, UNIPART, at https://www.unipart.com/resource/uk-government-invest-broadband.
[14] Ibid
[15] Kapko, M. (2023) Global cybersecurity spending to top $219B this year: IDC. Available at https://www.cybersecuritydive.com/news/cybersecurity-spending-increase-idc
[16] Cebreiro-Gómez, op.cit pp11; LaPlante, J., Ability-to-Pay and Benefit Principles, Encyclopaedia of Education
Economics & amp; Finance; available at https://sk.sagepub.com/ency/edvol/encyclopedia-of-education-economics-and-finance/chpt/abilitytopay-benefit-principles

Cross-border digital businesses obtain value from the market jurisdictions. Users of the various digital platforms constitute value to those platforms.[17] Users create both direct and indirect network effects, and enable those platforms achieve economies of scale and scope – another set of value.[18] The data of users which the platforms extract possess intrinsic value as well, hence their protection under privacy and data protection laws. The IMF has conceptualised user data as a valuable commodity:

"The point is clearest in relation to the information about themselves that consumers provide when, for instance, they use a search engine. This has meaningful similarities to the extraction of a natural resource: information, in this view, is akin to, say, oil. Just as the rents associated with natural resources are seen as a proper object of taxation where they are located, so might be the rents associated with information about a country's residents. The analogy with natural resources is not exact: information is not a rival good, whereas oil is. *But there are similarities: both are excludable, both might be seen as collective national assets, and just as the value of crude oil increases as it is refined and processed, the value of raw data increases as it is refined by algorithms and analytics. And critically, both are unique to a particular location."*[19]

It follows that, with this value creation, source jurisdictions have taxing right on the cross-border income of non-resident businesses attributable to their jurisdictions.

Multinationals' failure to pay income tax on their online business to market jurisdictions amounts to a transfer of wealth from those countries to the resident countries. For instance, in 2022 circa 70%, representing $13.5 billion of advertising expenditures in Canada went to non-resident online media organisations.[20] This phenomenon reduces the tax base of the source countries, and creates a deficit in the revenue that they require to finance their budgets, and meet developmental goals. Consequently, when source countries, in particular developing nations, impose digital tax on cross-border online business income they are not only preventing the wealth transfer, but they are also redistributing the wealth digital businesses create in those jurisdictions – a crucial function of taxation.[21]

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[17] Aslam, A. and Alpa, S. (2020), Tec(h)tonic Shifts: Taxing the "Digital Economy" IMF Working Paper, WP/20/76

[18] Ibid

[19] Corporate Taxation in the Global Economy, IMF Policy Paper, March 2019, pp15-16. Emphasis added.

[20] Audet, L. (2024) "Local news media are going, going, and may soon be gone. Only political courage will save them". The Globe and Mail

[21] Lawton, A. (2024). The function(s) of taxation: The impacts of regulatory taxes on taxation. Journal of Tax Research, 22(3), 518-546. https://www.unsw.edu.au/content/dam/pdfs/business/acct-audit-tax/research-reports/ejournal-of-tax-research/2024-12-ejournal-tax-research-v22-n3/2024-12-eJTR-the-functions-of-

Allocating the wealth, accumulated through digital tax, for public goods creates allocational efficiency – a situation where resources are distributed in a manner that achieves optimal societal benefit and welfare.[22] Allowing multinationals to siphon taxable income from developing and poor countries without tax may amount to acquiescence on the part of governments of these source countries in the wealth transfer. Therefore, the digital tax assists states to accumulate and allocate resources efficiently.

Tax law is a tool for social engineering. Indeed, one of the functions of tax is regulation of human behaviour;[23] a desired conduct may not be taxed, and *vice versa*. Digital tax may function as excise tax on certain goods which non-resident businesses trade online.[24] Some of these items include alcohol, and tobacco which a country may consider harmful to its population, thus may restrict their consumption. It may be easier to, effectively, control the sale of these products in domestic shops than to exercise the same level of oversight online given the growth in e-commerce. Digital tax can deter the cross-border online trading of these excise goods.

Digital tax objectives are implicit in two international tax frameworks: article 12B of the UN Model Tax Treaty, and Pillar One of the OECD/G20 Inclusive Multilateral Framework on Base Erosion and Profit Shifting (BEPS).[25] Article 12B of the UN Model Treaty authorises a contracting state to impose tax on the gross income of a non-resident sourced in that state's jurisdiction for Automated Digital Services.[26] This functions as a withholding tax on payments to the non-residents. Though this tax applies in the context of double taxation treaties based on that model, it constitutes a principled endorsement of the concept of digital tax.[27]

Piller One of the OECD Inclusive Multilateral Framework, which is not in force, requires non-resident multinationals with a turnover threshold of EUR20 billion and a gross profit that is more than EUR10 billion to set aside 25% of the excess profit (known as amount A) and allocate them pro rata to the source countries. Each source country then acquires a taxing right over its allocable share if the share is at least EUR1 million, or EUR250,000 in the case of

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[22] Allocational Efficiency, CFI Team; available at https://corporatefinanceinstitute.com/resources/economics/allocational-efficiency/

[23] Lawton, op.cit

[24] This is one of the interim measures recommended by the OECD Report on digital taxes. See Arnold, op.cit p235.

[25] Arnold, op.cit pp237-239

[26] Ibid, p237

[27] Cebreiro-Gómez, op.cit, pp29

countries with GDP of less than EUR40 billion.[28] This rule is a concrete admission, by the OECD, that there is normative justification for source countries to tax the income of non-resident online businesses. These international tax instruments provide international acceptance of the concept of digital tax except that they propose a treaty context for the tax's implementation.

Digital tax may prevent double nontaxation. Some digital companies, for tax avoidance purposes, create their residence in tax havens where they either pay little or no corporate taxes on their worldwide income. For instance, Google has its European headquarters in Ireland, a country with a 12.5% corporate tax rate; one of the lowest in the world.[29] This makes Google subject to tax in Ireland on its European business income. Failing to tax the income online businesses derive from market jurisdictions, on grounds of lack of physical presence and/or avoidance of double taxation, may conduce double nontaxation. Consequently, a source country's digital tax may prevent this tax avoidance scheme.

Double nontaxation may arise, also, from the fact that corporate income tax is paid, usually, on deferral basis. Some companies may avoid or evade the right corporate tax by padding their cost of sales and deductibles. Therefore, digital tax withheld at source from payments to non-resident digital companies, as in India's equalisation levy,[30] constitutes an effective tool for reducing double nontaxation, and tax non-compliance.

What is more, most of the cross-border digital multinationals possess the ability to pay the digital taxes even if it results in double taxation.[31] For instance, according to Fortune Global 500, in 2024, Amazon, Apple, Alphabet Inc (the parent company of Google), and Meta (parent company of Facebook) recorded revenues of USD574.8 billion, USD383.285 billion, USD307,394 billion, and USD134,901 billion respectively.[32] Having obtained substantial wealth from countries some of whom are either developing or poor, they ought to, progressively, pay more taxes and the digital tax compels the payment.

FACTORS AGAINST DIGITAL TAX

[28] Ibid, pp238-239

[29] Lyons, K (2021), Ireland's status as tax haven for tech firms like Google, Facebook, and Apple is ending; at https://www.theverge.com/2021/10/7/22715229/ireland-status-tax-haven-google-facebook-apple

[30] Chokhawala, M. (2025) Equalisation Levy: Applicability, Due Date, Payment And Returns; Cleartax.in

[31] LaPlante, op.cit on Ability-to-pay principle

[32] Available at https://fortune.com/ranking/global500/2024/

There are rationales against unilateral introduction of digital tax. These reasons may render the tax problematic or unreasonable:

It may be expensive to successfully implement digital tax. For example, the UK estimated to spend GBP8 million to install new systems to implement its digital services tax in 2020.[33] The source countries may have to acquire new IT infrastructure, introduce new processes of compliance, and employ new staff to monitor digital transactions. Besides, there ought to be real time transaction monitoring for tax authorities to identify the details of each transaction to prevent evasion through under declaration. The new infrastructure and bureaucracy may create expensive upfront costs and recurrent expenditures for governments, thereby making it difficult for poor countries to implement the tax.

Compliance issues may impede the implementation of digital tax. After instituting new systems for the tax, it may be difficult for source countries to enforce non-compliance against non-resident companies since the latter may have no assets in the source countries for attachment. Moreover, because digital tax is a unilateral tax the taxing countries are unlikely to obtain co-operation from the resident countries in the enforcement process as the latter may, among others, view the process as an affront to their sovereignty.[34] Even if the tax is administered as a withholding tax digital users who may not be sophisticated in tax matters may struggle with the withholding process, and create non-compliance as a result.

Tax authorities' constant monitoring of online transactions, and disclosure requirements inherent in the compliance processes may create potential violation of privacy and data protection rights. Tax authorities may abuse their powers by monitoring the personal data of users which are protected by privacy and data protection laws.[35]

Monitoring of digital interactions for tax purposes, and fear of violation of personal data and privacy may dissuade the local population from engaging in digital interactions, thereby reducing the scale of internet users in the source country. Such a situation risks alienating part of a country's population from accessing information and education digitally. This probable

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[33] Policy Paper: Introduction of New Digital Services Tax, HM Revenue & Customs, 11th July 2019, at https://www.gov.uk/government/publications/introduction-of-the-new-digital-services-tax/introduction-of-the-new-digital-services-tax

[34] Report on Investigation into the Digital Services Tax, HM Revenue & Customs, by the National Audit Office In UK, dated 22nd November 2022; paragraph 14 of the Summary.

[35] Judijanto, L. (2024), Concerns over the Protection of Taxpayers' Privacy Data on The Core Tax Administration System, Archives Des Sciences, Vol.74 Issue 6, pp 80-85; http//www.unige.org

unintended consequence of digital tax constitutes the reverse outcome of the function of tax as a tool for regulation of human behaviour.[36]

Source countries' imposition of digital tax on income of non-resident businesses is in tension with a key principle of international tax law: That the business income of an undertaking should be taxed by the resident jurisdiction or by the source country where the undertaking has a physical presence in the form of a permanent establishment and the income is attributable to that establishment.[37] The inconsistency of a source country's digital tax with the above principle, arising from the taxpayer's lack of physical presence, is likely to court international resistance and condemnation of the tax.

Resident jurisdictions may retaliate against source countries' unilateral introduction of digital taxes. The retaliatory actions may be in different forms. A case in point is the U.S' threat of tariffs on imports from the UK, India and other countries that charge US digital companies digital services tax (DST).[38] Upon assumption of office in 2025, President Donald Trump issued a memorandum directing his administration, especially the US Trade Representative, to investigate and contest the digital taxes that foreign countries impose on U.S tech companies.[39] Such threats of retaliatory actions may weaken the resolve of some countries to implement the tax.

The U.S. has characterised the digital services tax as discriminatory. This is because, according to the country, the tax disproportionately affects its companies and reduces, significantly, the country's tax base.[40] There is some evidence to this claim. For example, a study by Computer & Communication Industry Association (CCIA) Research Centre revealed that Canada's digital tax would cause U.S technology firms a direct revenue loss of USD2.3 billion annually, and would lead to significant full-time job losses also.[41] The U.S. also accused Canada that its DST's discriminatory nature violated the United States-Mexico-Canada

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[36] Lawton, op.cit

[37] Article 7 of OECD, and UN Tax Treaty Models; See also Arnold J. Op.cit, and Erasmus N. Op.cit.

[38] Fact Sheet: President Donald J. Trump Issues Directive to Prevent the Unfair Exploitation of American Innovation. The White House, February 21, 2025, https://www.whitehouse.gov/fact-sheets/2025/02/fact-sheet-president-donald-j-trump-issues-directive-to-prevent-the-unfair-exploitation-of-american-innovation/

[39] Ibid

[40] CCIA Welcomes US Push Back Against Digital Service Taxes Targeting US Companies, Computer & Communication and Innovation Association (CCIA), January 22, 2025. Available at https://ccianet.org/news/2025/01/ccia-welcomes-us-push-back-against-digital-service-taxes-targeting-us-companies/

[41] Ibid

Agreement (USMCA), and requested dispute resolution under the bilateral treaty.[42] It is noteworthy, that on 30th June 2025, the date for the first payment under the Canadian DST, Canada rescinded the tax against U.S. companies to enable trade negotiations between the two countries to resume after President Donald Trump had spurned the talks owing to the DST.[43]

While the claim that the DSTs disproportionately impact U.S. companies is founded because most of the big digital companies have U.S. origin, the charge of discrimination, outside the context of a treaty like USMCA, is a stretch. Nevertheless, countries implementing digital tax, as a revenue measure, ought to be conscious of the U.S's position on same given the political and economic heft the country possesses.

Countries' unilateral implementation of digital tax creates double taxation. As stated earlier, in the absence of a contrary treaty provision, resident companies pay taxes on their worldwide income to their countries of residence. Therefore, where a market jurisdiction charges digital tax on a non-resident income the same income becomes subject to tax in the resident jurisdiction creating a double taxation.[44] This fiscal mischief has the potential to erode the profits of small and medium size businesses thereby either foreclosing their cross-border businesses or rendering them non-competitive.

To survive, and at the risk of becoming non-competitive due to potential elasticity of demand, some businesses may increase the prices of their products and services in response to digital tax. As Najeev (2025) observed, some firms, like Spotify, Amazon prime, and Netflix, may pass on the tax to their customers by increasing their subscription fees.[45] These increments may render the cost of local browsing for social and economic purposes prohibitive and reduce local online user traffic.

CONCLUSION

Digital business has grown in leaps and bounds. It has created wealth for several digital companies. Part of this wealth emanate from jurisdictions in which these businesses have no

[42] Understanding Digital Services Taxes, Public Citizen. Available at https://www.citizen.org/wp-content/uploads/Understanding-Digital-Services-Taxes.pdf

[43] Monga V. (2025) Canada Rescinds Digital-Services Tax to Salvage Trade Discussions with US, at https://www.msn.com/en-us/money/other/canada-rescinds-digital-services-tax-to-salvage-trade-discussions-with-us

[44] Arnold, op.cit pp36-37

[45] Najeev (2025), India's Digital Taxation: Issues and Solutions; available at https://taxguru.in/income-tax/indias-digital-service-taxation-issues-solutions.html#google_vignette

physical presence. As a principle of international tax law, the absence of physical presence disqualifies these market jurisdictions from taxing this stream of income.

The efforts of the United Nations, and OECD to mould digital tax into an international framework constitute international recognition of digital tax, in principle, as a reasonable revenue handle. The germane issue is what form – unilateral, bilateral, or multilateral – must it take? A multilateral resolution of this impasse is the most efficient approach, as it will curtail the multiple unilateral disparate actions. Google rightly opined in its public statement, after paying USD1 billion to settle its digital tax dispute with France, that: "We remain convinced that a coordinated reform of the international tax system is the best way to provide a clear framework to companies operating worldwide."[46]

In the meantime, source nations' current unilateral digital tax is reasonable as, among others, its revenue generation capacity outweighs the costs. For instance, the UK earned GBP358 million from digital services tax for the year 2020-2021,[47] after the GBP8 million roll-out cost in April 2020. Adam Smith (1755) presciently observed:

"Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism, but peace, *easy taxes* … all the rest being brought about by natural course of things."[48]

[46] Google pays France over $1billion to settle tax case, the Associated Press, at https://www.nbcnews.com/tech/tech-news/google-pays-france-over-1-billion-settle-tax-case

[47] Available at https://publications.parliament.uk/pa/cm5803/cmselect/cmpubacc/732/report.html#:

[48] Adam Smith (1755), An Enquiry Into the Nature and Causes of the Wealth of Nations (Canned ed.), Vol 1, at https://oll.libertyfund.org/titles/smith-an-inquiry-into-the-nature-and-causes-of-the-wealth-of-nations-cannan-ed-vol-1#Smith. Emphasis added.