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A Digital Liberation Day for Europe?

A Concept for a Targeted Response to US Protectionism and Blackmail

Matthias Kullas, Henning Vöpel, André Wolf

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New US import tariffs threaten Europe's export potentials in many critical industrial sectors. Neither a wait-and-see attitude nor the resort to own industrial protectionism are appropriate answers to this threat. Instead, the situation requires smart measures that directly target those areas where the US economy is highly trade dependent itself. This concerns service trade, in particular trade in digital services, where the US has built up a trade surplus compared to the US that almost matches the deficit in merchandise trade. Precisely, several arguments can be made for taxing big US digital companies operating on EU markets. In many EU Member States, these multinational digital service providers currently pay very little tax even though they realize high returns. This cepAdhoc presents a conceptual framework for a targeted taxation. But in search of a response to the US tariffs the EU must be aware of two aspects: 1. The EU is critically dependent on US digital services and therefore cannot easily substitute those services, 2. Taxing a foreign monopoly can adversely make EU consumers worse off. Both aspects imply the same task: The digital playbook of the new commission must be targeted to make the EU digitally sovereign in terms of digital infrastructure as soon as possible thereby giving the EU tech industry an opportunity to scale up and to innovate.

- cep proposes a "synthetic concept" based on breaking down the digital service value chain into i) the data service (the individual information), ii) the system service (the software, servers and algorithms) and iii) the network service (the infrastructure).
- This concept provides three possible solutions for taxation at the "last identifiable source": (i) a digital sales tax on the domestically consumed service under the market jurisdiction principle, (ii) a digital duty on the imported system service and (iii) a digital fee for using the network infrastructure provided domestically and used by foreign providers.
- In order to create a credible bargaining chip against US protectionism and even more important to get prepared for aa potential turning away of the US from democratic values and rule-of-law principles, the EU must build up a sovereign digital infrastructure as a key priority for preserving prosperity and security.

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1 From Trade War to Tech Sovereignty: The EU's Battle for Digital Independence

On April 2, 2025, Donald Trump announced tariffs of 20 percent on almost all physical goods from the EU. As a justification, he cited the EU's high trade surplus in these goods with the US. However, this justification ignores trade in services. If we look at this, a different picture emerges, because here the EU has a deficit in trade with the US. This deficit is particularly due to a trade deficit in digital services, that almost matches the deficit in merchandise trade. In 2020, the estimated turnover of US digital service providers in the EU amounted to more than 160 billion euros, compared to only around 20 billion euros for EU digital service providers in the US market.[1]

The EU has already announced its intention to enter into negotiations with the US to reduce or eliminate tariffs. In order to improve its position in such negotiations, the EU should first also impose tariffs on US imports. In this context, a tariff on imported US digital services is repeatedly discussed.

The imposition of tariffs on EU imports is just one of many measures in recent months that show that the US is no longer a reliable partner. Rather, the US government is exploiting the weakness of other countries to achieve its own advantages. The EU should therefore reduce its digital dependence on the US, but also on other unreliable partners. It is not just a question of maintaining prosperity and competitiveness, but - as a precondition - of defending geostrategic sovereignty and authority over technology and infrastructure. European dependence on American digital service providers is already high and, if nothing is done, will continue to grow. The big Internet giants of today are also driving investment in Artificial Intelligence (AI), securing the business models and growth areas of the future. They are exercising their market power along increasingly digital value chains, expanding them and penetrating more and more into traditional business areas, making more and more sectors of the traditional economy, including the non-digital economy, dependent on them.

The third problem is the aggressive tax planning of US digital service providers through so-called BEPS (base erosion and profit shifting) practices. In many EU Member States, multinational digital service providers pay hardly any taxes. They therefore contribute little or nothing to the financing of public goods in the EU, even though they generate high returns on European markets.

European countries are losing billions in revenue due to the lack of fiscal intervention in multinational digital services. The ifo Institute estimates that the annual revenue potential of a tax on income from the sale of user data, online advertising and brokerage on online marketplaces alone would amount to around three to four billion euros.[2] A recent CEPS study, with slightly different assumptions, in particular a higher tax rate, estimates annual revenues of even EUR 37.5 billion.[3] This adds to the free use of public goods and other infrastructure to which the multinational digital providers contribute little or nothing. On the contrary, the EU's 'tax waiver' is causing lasting economic damage by underfunding digital infrastructure and leaving digital business models developed in the EU in a worse tax position.

[1] Kullas, M., Vöpel, H., Wolf, A. (2024). Digital Services: European Solutions for Fair Taxation of Multinational Digital Service Providers. cepStudy.

[2] This includes revenues from the sale of user data, online advertising and the provision of online marketplaces. These revenues amount to around 132 billion euros. A digital sales tax of 3% is levied on these revenues in the calculation. Companies with a global annual (group) turnover of at least 750 million euros are subject to the tax (see ifo, Die Besteuerung der Digitalwirtschaft, 2018).

[3] See CEPS (2025): Towards a European Digital Service Tax: Renewing the Momentum for a Fair Contribution.

The market power of US and increasingly Chinese digital providers combined with the increase in digital value creation (AI, Metaverse, Web3.0) will lead to even greater tax losses in the coming years. More and more wealth will flow out of Europe if the market power of the large foreign digital providers is not curbed. Moreover, an unresolved problem is the large language models that systematically violate copyrights on a massive scale without compensating authors for the use of their intellectual property.

The current market power of the big internet giants dates back to the beginning of the commercialization of digital innovations on mass markets in the mid-2000s (smartphones, apps, social media, etc.). Today, it poses a structural, competitive and ultimately regulatory problem for the European digital economy - with consequences that reach deep into society, the economic interests and the normative order of the EU, considering the dangers of manipulation and disinformation for democracy and the rule of law.

2 Digital Monopolies: The Quasi-Sovereign Power of the Platforms

Against this backdrop, regulators have a role to play in enforcing fiscal sovereignty, defending digital sovereignty and creating a level playing field for SMEs. Digital value creation has specific characteristics compared to industrial value creation. In particular, network effects and economies of scale favor the creation of market power. Its intangible nature makes it difficult to capture physically or spatially. The drivers and main beneficiaries of digitization today are predominantly multinational digital service providers in US hands, whose dominance and market power are constantly growing. This development poses three major problems for EU policy makers:

Problem 1: High concentration and low competition in digital markets

Competition in digital service markets is not functioning well at present. This is due to significant economies of scale, and network effects. Digital markets are therefore often dominated by a small number of providers.

Problem 2: High digital dependency and threat to digital sovereignty

The dominance of multinational US digital service providers in European markets threatens the digital sovereignty of the EU. The EU is dependent on US digital service providers in more and more areas. Such dependence makes it difficult to enforce European values and rules.

Problem 3: Aggressive tax avoidance by multinational digital service providers

Multinational digital service providers often minimize their tax burden by artificially understating their tax assessment basis and/or shifting their profits to low-tax countries (*base erosion & profit shifting*, *BEPS*). Companies that minimize their tax burden in this way contribute very little to the financing of public infrastructure and other public assets, even though they benefit from them.

3 Proposal for a Synthetic Taxation[4]

The cep proposal is conceptually based on a decomposition of digital value creation added with the aim of tracing its creation back to its ultimate sources and then taxing them. A digital service and its business models are conceptually divided into three components: (i) the provision of software,

[4] "Synthetic" refers to the interaction of the three proposed types of measure in formulating a holistic concept of the taxation of digital services.

(ii) access to the telecommunications network and (iii) user interaction. In many cases, this is a two-way process: users are not only recipients of information, but as 'prosumers' they also provide information, e.g. social media content, customer reviews, etc., which improves the quality of digital services, trains algorithms and AI, and thus increases the network effects of digital business models. We can therefore distinguish three types of sources of value based on which the major digital providers can create revenues:

- The **provision of software** as a **“**system service” (by digital service providers to other digital service providers; often intra-group).
- The **access to the digital infrastructure** as a “connectivity service” (by network operators to digital service providers and their users).
- The **interaction with users** as an “interaction service” (between digital service providers and their users).

This breakdown produces three possible measures for taxing digital services:

- A **digital import duty on system software** (→ system service), i.e. on the cross-border transfer of ownership and usage rights to software, licenses, etc. that implement the system service (“digital duty”).
- A **digital fee for network access** (→ connectivity service) according to the *sender pays*[5] principle (as envisaged by the EU Commission). The network access fee can be designed via auction procedures in such a way that digital rules are enforced in favor of greater digital sovereignty.
- A **digital sales tax** (→ interaction service) on revenues from users' value-added contribution to digital services (“digital tax” in accordance with the EU proposal; for two-sided markets, the national advertising revenue).

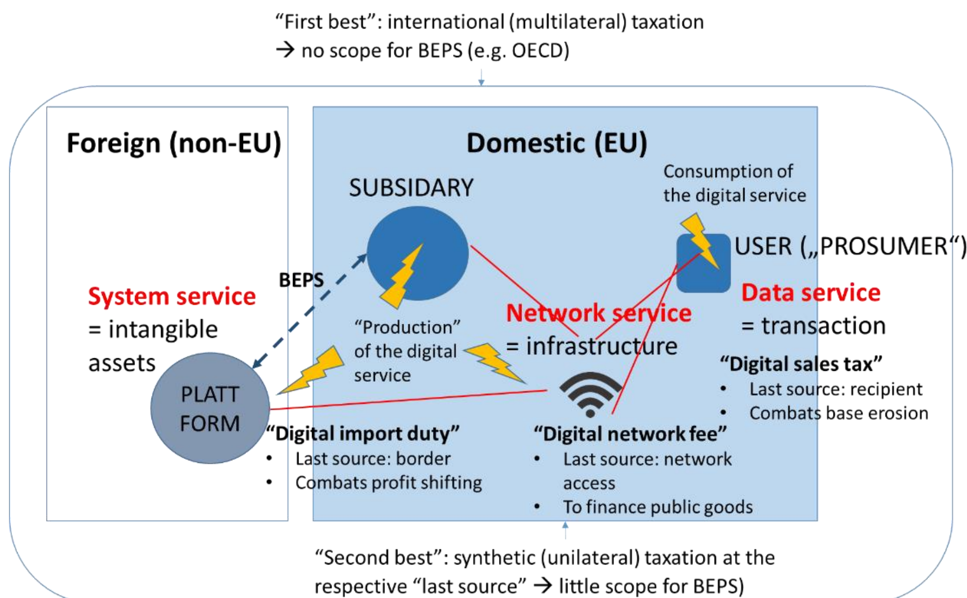
The central idea of this concept is to use existing instruments to create a kind of 'net' for the taxation of those parts of digital value added which are physically and territorially not or hardly attributable. It ensures that large multinational digital providers can no longer easily 'slip through' by means of BEPS practices. The single measures are explicitly not necessarily cumulative but complementary, i.e. they do not lead to unintended multiple taxation.

The use of revenues differs between the three measures. The digital import duty would flow into the EU budget as customs revenue and could be used to finance the structural investments needed for the transformation. The revenue from the digital network fee could be earmarked. For instance, it could be used to finance the expansion of digital networks. The revenue from the digital sales tax could be used freely. The specific design of the measures is important. Especially when taxing monopolies, passing on the tax could ultimately disadvantage consumers. Nevertheless, such 'countervailing duties' would redistribute some of the monopoly rents and tax losses currently accruing to the EU. When considering the segments 'Licenses to reproduce and/or distribute computer software' and 'Computer software; software originals' from the OECD EBOPS statistics, relevant EU imports in 2019 (most recent data) amounted to 4.2 billion euros. At a tariff rate of 20%, this would imply a revenue potential from a digital import duty of around 800 million euros per year (not taking into account evasion effects). As not even all EU Member States report trade data in these segments, this would be a rather conservative estimate, even without considering evasion effects. In comparison, EU customs revenues in 2022 amounted to around 25 billion euros. The third measure overcomes the free-riding of multinational digital service providers in the financing of public goods and network infrastructures. In this respect,

[5] I.e. the principle that infrastructure costs arising from data traffic are paid at least in part by content providers (as the main data-sending organisations).

a digital network access fee can fill a gap, especially for streaming services, which account for a significant share of data transfer.

Figure 1: Starting points for the taxation of digital services



Source: Authors' illustration.

4 Conclusion

Trump's protectionist trade policy is increasing the pressure on a European industry already struggling with declining competitiveness. Neither a wait-and-see attitude nor the resort to own industrial protectionism are appropriate answers to this situation. Instead, the situation requires smart measures that directly target those areas where the US economy is highly export-oriented itself. This concerns service trade, in particular trade in digital services, where the US has built up a trade surplus compared to the US that almost matches the deficit in merchandise trade. Precisely, a case can be made for taxing big US digital companies operating on EU markets. In many EU Member States, these multinational digital service providers currently pay very little tax even though they generate de facto high profits there. This cepAdhoc presents a conceptual framework for a targeted taxation. It rests on a "synthetic concept" based on breaking down the digital service value chain into i) the data service (the individual information), ii) the system service (the software, servers and algorithms) and iii) the network service (the infrastructure). This produces three possible solutions for taxation at the "last identifiable source": (i) a digital sales tax on the domestically consumed service under the market jurisdiction principle, (ii) a digital duty on the imported system service and (iii) a digital fee for using the network infrastructure provided domestically and used by foreign providers.

Of course, the implementation of these measures is not without risk for EU consumers. As in most other cases, taxes and tariffs could be passed on to the demand side, implying that domestic consumers would face higher prices for digital services with little short-term substitution potential. Our approach should therefore not be seen as an ideal solution to the problem of digital dependency, but rather as an addition to the EU's arsenal of defensive measures, improving the EU's position in future trade talks and contributing to a fairer business environment for the domestic digital sector.

Authors:

Dr. Matthias Kullas, Division Head
kullas@cep.eu

Prof. Dr. Henning Vöpel, Director Centrum für Europäische Politik and
President of the Stiftung Ordnungspolitik
voepel@cep.eu

Dr. André Wolf, Division Head
wolf@cep.eu

Centrum für Europäische Politik FREIBURG | BERLIN
Kaiser-Joseph-Straße 266 | D-79098 Freiburg
Schiffbauerdamm 40 Raum 4205 | D-10117 Berlin
Tel. + 49 761 38693-0

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