Ring-fencing Digital Corporations: Investor Reactions to the European Commission's Digital Tax Proposals

This study reviews the European Commission's proposals on the taxation of digital corporations and employs a traditional event-study methodology (Brown and Warner, 1985; Kothari and Warner, 2007) to analyze investor reaction to potentially ring-fencing tax measures. The two on March 21, 2018 proposed directives suggested the introduction of an interim tax on gross revenues from certain digital services and laid down the rules of taxing corporate profits that are attributable to a significant digital presence. Despite not reaching consensus on an EU-wide level, several European countries (e.g., France, U.K. and Spain) intend to or have already implemented some of the proposed measures unilaterally. Furthermore, parts of the proposed measures are still subject to debate on OECD level (OECD, 2019).

Employing Google Trends Analysis, we identify the highest attention towards the proposals on March 21, 2018 and the following day and consequently, use these days as our event window. Examining the stock market returns, we find – depending on our expected return specification – a significant negative capital market reaction between -0.69% and -2.03% for a portfolio of 222 likely affected digital corporations, with annual revenue above EUR 750 million, in response to the European Commission's digital tax proposals. In different cross-sectional analyses, we find that the capital market reaction is, as expected, stronger for loss-making firms, firms located in the EU and inversely related to firms' revenues. Based on our findings, we estimate an overall abnormal market value decrease of digital and innovative corporations by about EUR 52 billion in response to the proposed measures, thereof about 40% is attributable to U.S. based corporations. To ensure the robustness of our main findings, we employ additional regression analyses as well as various statistical tests and replicate our results using a value-weighted portfolio approach.

Our findings contribute to the recent call in the literature for further research on the proposed policies of taxing the digital economy and help to evaluate the effects of ongoing efforts in the European Union to implement elements of the digital tax proposal unilaterally (Bauer et al., 2019; Olbert and Spengel, 2019). Furthermore, the findings of this study contribute to the academic debate on reform proposals to adapt the general tax framework to the era of digitalization and highlight the potentially unintended effects of measures that ring-fence digital and innovative corporations (e.g. Andersson, 2017; Brauner and Pistone, 2018; Devereux and Vella, 2018; Olbert and Spengel, 2017). Finally, this paper is related to the literature that examines whether tax policy changes affect stock prices (Gaertner et al., 2019; Hoopes et al., 2016; Overesch and Pflitsch, 2019).

JEL Classification: H25, H26, K34, G14

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