# TAXATION ARISING FROM DIGITALISATION: ISSUES AT STAKE

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**Abstract:** *The OECD is leading global efforts to reach an international consensus around the BEPS Project with the G20 support. Action 1 works on the tax challenges of the digital economy and its proposals have been made with the «inclusive framework» participation that brings together more than 137 countries. The article focuses on the legitimacy, operation, and consequences of all this work for developing countries that, according to estimates of the UNCTAD, lost annually U$100 billion due to tax avoidance schemes by MNEs. The OECD/G20 inclusive framework is designing a new global tax structure and its proposals attempt to introduce new rules on taxing rights allocation and distribution. At the same time, some countries have adopted unilateral measures in order to tax some digital businesses. Finally, the European Union Countries continue to delay the adoption of the CCCTB and DST Directive proposals, and the United States has introduced the GILTI legislation that seeks to tax the global intangible income. Everything seems to indicate that in the next years the international tax architecture will be changed in deep.*

**Keywords:** *Taxation, Digitalization, G20, OCDE, Multinationals companies (MNE's).*

## 1. INTRODUCTION

In the last fifteen years, the world has undergone unprecedented change as a result of the new technological advances, the "platform revolution" (Parker et al, 2016), and the digitalization of the whole economy (Knickrehm et al, 2016). On the other hand, the new business models (OCDE, 2015) have shown their high capacity to use optimization practices to avoid paying their fair share of taxes exploiting loopholes in the international tax regulation, distorting the meaning of the Double Tax Conventions, and taking advantages of inadequate principles, outdated concepts and unsatisfactory policies to taxing the international income (Graetz, 2001), especially the income earned by Multinationals Companies (MNE's).

In this context, and probably due to the scandals related to the low taxes paid by some of these companies, the G20 and the OCDE has been encouraging the Base Erosion and Profit Shifting Project (BEPS) with the participation of the inclusive framework, that is, one hundred and thirty-seven countries and jurisdictions interested to collaborate in the implementation of the BEPS package, including fourteen observer organizations. According to the last inclusive framework Progress Report (OCDE, 2020), it is a major shift in global governance on international tax matters that has occurred. Together, only a hundred members represent more than 93% of global GDP, reflect a broad diversity of economic profiles and levels of development and show that the tax challenges are global and require global solutions through enhanced international cooperation.

So, the G20/OCDE inclusive framework on BEPS is working intensely in order to design a "new international tax architecture", to solve the big challenges that the digital economy has created. In that context, it is important to keep in mind how, for example, UNCTAD (2019) has highlighted that the digital technologies and digital platforms are closely linked to two coun-

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tries: the United States and China. These two economies account for 75% of all patents related to blockchain technologies, 50% of global spending on the Internet of things, at least 75% of the cloud computing market, and 90% of the market capitalization value of the world's 70 largest digital platform companies (Europe's share is 4% and Africa and Latin America's together is only 1%). In addition, for example, the seven biggest platforms (Microsoft, followed by Apple, Amazon, Google, Facebook, Tencent and Alibaba) account 2/3 of the total market value and the only United States hosts more than half of the top hundred websites used in the world.

The article wants to deepen this topic and analyze what are the main consequences of the G20/OCDE new design. The inclusive framework has a legitimacy deficit or is it the best way to introduce changes at the global level? Who are the winners and losers of this new design?

## 2. INCLUSIVE FRAMEWORK AND SOFT LAW

According to the initial OECD Reports on BEPS (2013), the weaknesses of the international tax structure put the original consensus-based framework (League of Nations, 1920) at risk. The multilateral inaction in this area could cause that some governments – who would not be willing to continue losing corporate tax revenues – to decide to replace this consensus with unilateral measures in order to protect their tax base and create global tax chaos marked by uncertainty and unrelieved double taxation. In that context, the G20 Leaders saw multilateralism as the best asset to resolve the global economy's difficulties and opt to design the new international standards to ensure the coherence of corporate income taxation at the international level in order to cut loopholes, gaps, frictions, or mismatches created by the interaction of countries domestic tax laws. At this time, the OCDE/G20 highlight how the International Tax Law is the key pillar in supporting the growth of the global economy and only talks about international coordination.

So, in June 2016 the inclusive framework was established, and the developing countries (non-OCDE members) were invited to participate on an equal footing which provided such countries implementation of "four minimum standards" to deal with harmful tax competition (action 5), treaty abuse (action 6), transfer pricing documentation (action 13) and mechanism of dispute resolution (action 14). The four standards will be subject to a peer review and monitoring process in all the countries participating on the BEPS inclusive framework. In the same line to what has been done, for example, through the *Global Forum on Transparency and interchange of information for Tax purpose* (with over 160 members including all the OCDE members, Financial Centres, Developing Countries and 19 Organisations as observers) the implementation of two international standards has been achieved:

(1) The AEOI (automatic exchange of information), which in the last three years has allowed the interchange of 84 million of financial accounts, covering a total asset of EUR 10 trillion.

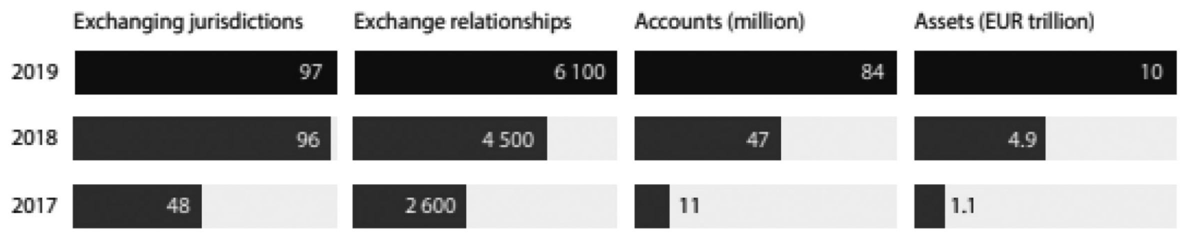


**Figure 1.** AEOI (automatic exchange of information)
**Source:** Global Forum on Transparency (2020).

(2) The EOIR (exchange of information on request) that in ten years has tripled the number of requests of tax information from 9.208 in 2009 until 28.536 in 2019 (figure 2).

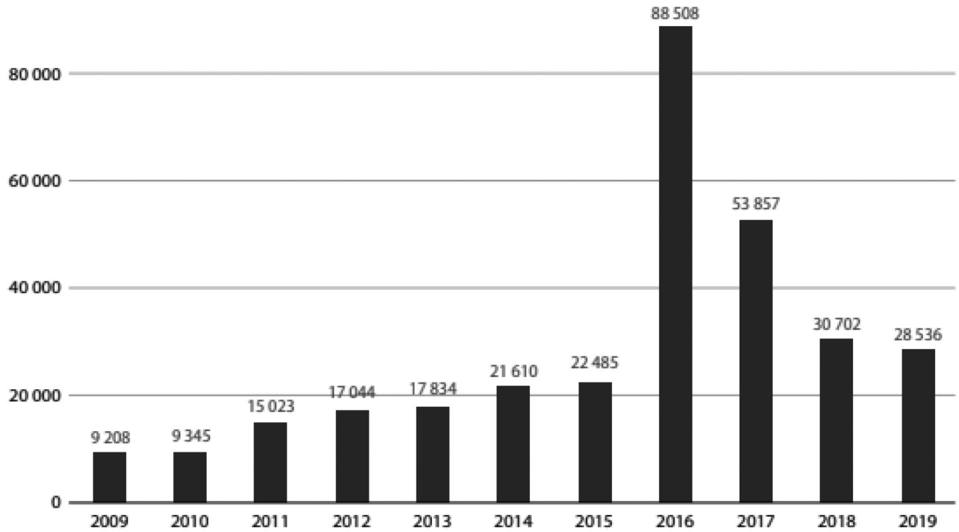


**Figure 2.** EOIR (exchange of information on request)

**Source:** Global Forum on Transparency (2020).

As regards the satisfactory implementation of the "tax transparency standards" the G20 Finance Ministers requested to the OECD a regular report about the jurisdictions that "fail" to comply with these standards in order to ensure a level playing field. In the last Report (2021) the number of opaque jurisdictions has decreased from 15 to 5, that is: **Dominica, Niue, San Martin, Trinidad and Tobago and Anguilla**. In other words, after all these years only these five little jurisdictions are considered "non-cooperative" (read as "tax havens") and obviously that´s unconvincing to some unbelievers.

Furthermore, the 2021 aforementioned Report states the result of the compliance with the four international tax standards required to be part of the OCDE inclusive framework: 300 tax regimens reviewed (action 5), 95 jurisdictions signed the BEPS Multilateral Instrument (action 6), 90 jurisdictions introduced the Country-by-Country reporting (action 13) and 82 jurisdictions have been reviewed in order to improve mechanism on dispute resolution and around 1800 recommendations have been made (action 14). All this is only the beginning of the "new global tax physiognomy" if we consider the fifteen BEPS actions and the number of inclusive framework members.


**Figure 3.** Four international tax standards

**Source:** OECD (2021)

For the OCDE (2021) to build effective tax systems in developing countries has never been more important, and to achieve that goal is necessary «to ensure that developing countries benefit from significant changes in the international system». In this context, it has launched 43 bespoke induction programmes to support the inclusive framework members to implement "their

BEPS priorities and build capacity" and has encouraged the OECD/UN Tax Inspectors Without Borders (TIWB) initiative – with 84 programmes completed and 21 forthcomings – that have helped to raise over USD 774 million in additional tax revenues and overall tax assessments in excess of USD 2.3 billion up to the end of 2020.

Undoubtedly, the OCDE (2020) is making the international tax structure more uniform with the support of the inclusive framework currently distributed as follow: Africa 18%, Asia-Pacific 15%, Western Europe 22%, Americas (North America, Latin America and the Caribbean) 26%, and Eastern Europe-Central Asia 19%. At the tax level, this is – together with the European Union harmonization process – the most important change that has ever been made and probably for that reason some institutions have questioned the legitimacy of all this work. Thus, for example, the Independent Commission for the Reform of International Corporate Taxation (ICRICT, 2019) has pointed out that the OECD/BEPS process has been designed by developed countries, mainly for developed countries, and most developing countries may not have the capacity to assess and reap its benefits.

The ICRICT is concerned about the legitimacy of the OECD about the way developing countries are participating in the shaping of global tax standards. The BEPS process "is being implemented as the new global standards applicable to all countries and the developing countries should therefore carefully evaluate the opportunity cost of engaging in the inclusive framework and the practicability of signing up to and implementing the BEPS outcomes that may not address their needs".

In November 2019, the ICRICT has been ever harder: "The distributive implications of the pillar one proposal are unclear, as the OECD has not published any economic impact analysis in order to support their proposal. Countries are asked to sign up to a "consensus proposal" without the economic impact being made publicly available for scrutiny". The ICRICT urged the OECD secretariat to publish the economic impact analysis of this proposal before the inclusive framework meeting in January 2020, along with the full data from multinationals country by country reporting. Thus, in October 2020 the OCDE has been published the economic impact assessment and we are waiting for the ICRICT detailed analysis about it without losing sight that the Report on Pillar One Blueprint has been published at the same time. Curiously, the Inclusive Framework meeting on 8-9 October 2020 approved the Report on the Pillar One Blueprint for public release in the following terms:

*«It is designed to deliver a sustainable taxation framework reflective of today's digitalizing economy, with the potential to achieve a fairer and more efficient allocation of taxing rights. The Blueprint reflects the extensive technical work that has been done. Though no agreement has been reached, the Blueprint nevertheless provides a solid foundation for a future agreement that would adhere to the concept of net taxation of income, avoid double taxation and be as simple and administrable as possible. The Blueprint offers a solid basis for future agreement ... We agree to swiftly address the remaining issues with a view to bringing the process to a successful conclusion by mid-2021 and to resolve technical issues, develop model draft legislation, guidelines, and international rules and processes as necessary to enable jurisdictions to implement a consensus-based solution».*

The United Nations (2019) has also noted that any consideration of tax measures in response to the digitalization of the economy should include a thorough analysis of the implications for developing countries with a special focus on their unique needs and capacities. Nevertheless, the United Nations Tax Committee (2021) recently – in time to include the new article 12B on automated digital service in the 2021 Model Convention – has indicated in relation to the "tax consequences of the digitalized economy: issues of relevance for developing countries" and the work developed by the OECD/G20 Inclusive Framework on BEPS, that is better "be awaited to ensure that any United Nations alternative *would be consistent* with a multilateral approach". It is not surprising because in the twentieth session of the Tax Committee (2020) many members have stated their intention to follow the OECD/G20 Inclusive Framework position.

In short, probably within some time, the action one on the BEPS OCDE/G20 Project will be adopted and its conclusions will be applied progressively, at least, in one hundred and thirty-seven countries around the world. The picture is similar to that which has developed under the umbrella of the OECD Model on Double Tax Convention since most of the bilateral Tax Treaties have been signed following not only its articles but also its interpretation guidelines. The OECD is no longer limited to giving Recommendations to its Countries Members but now is in charge of design the new global tax structure. Obviously, its legitimacy is in question, but its proposal goes ahead and is very difficult for that to change due to the interest at stake and the lack of valid interlocutors. It is the new international tax soft law? Or is more than it?

## 3. WHAT ARE THEY GOING TO CHANGE?

The digital economy is characterized by an unparalleled reliance on intangible assets, the massive use of data (including personal data), the widespread adoption of multi-sided business models capturing value from externalities generated by free products, and the difficulty of determining the jurisdiction in which the value creation occurs (OECD, 2013). In that context, the key questions are how MNE's in the digital economy add value and make their profits, and how the digital economy relates to the concepts of source and residence or the characterization of income for tax purposes. In fact, the new ways of doing business may result in a relocation of core business functions and, consequently, in a different distribution of taxing rights.

For those reasons, initially, the BEPS Project sought four specific objectives: (1) Establishing international coherence of corporate income taxation (action 2, 3, 4, and 5); (2) Restoring the full effects and benefits of international standards (action 6, 7, 8, 9 and 10); (3) Ensuring transparency while promoting increased certainty and predictability (action 11, 12, 13 and 14); and, (4) Agreed policies to tax rules, that is, swift implementation of the measures adopted (action 15). In that context and four years after the establishment of the inclusive framework, the Blueprint Report (OCDE/G20,2020) stated how Pillar One is focused on finding *new nexus and profit allocation rules to ensure the allocation of taxing rights with respect to business profits* no longer exclusively circumscribed by reference to the physical presence of the MNE's.

The traditional notions of permanent establishment and the arm's length principle has been changed and are important enhanced tax certainty through a more extensive multilateral tax cooperation. Thus, right now the Pillar One show three key elements: (1) A new taxing right for market jurisdictions over a share of residual profit calculated at an MNE group level (called amount A); (2) A fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction, in line with the arm's length principle (called amount B); and (3) A processes to improve tax certainty through effective dispute prevention and resolution mechanisms.

For the construction of Pillar One, the OCDE have been identified eleven building blocks that constitute the bedrock of its work that can be grouped as follows: (a) In relation to the above first element (called amount A) the blocks are tax scope, nexus, revenue sourcing, tax base determination, profit allocation and elimination of double taxation; (b) In respect to the second element (called amount B) the blocks are tax scope and quantum; and, (c) Looking tax certainty, the blocks are dispute prevention and resolution for amount A, and dispute prevention and resolution beyond amount B. The building is close to analyzing the best way to implement and administration of the new rules. Explain in detail all these technical issues and their possible consequences are not appropriate for an article like this, however, anyone can guess its importance especially for most developing countries.

Probably due to this lack of confidence, in relation to some types of digital activities, some countries have adopted unilateral measures around the world. In *Europe*, for example, Spain, France, Italy, Austria, Hungary, Poland, Turkey and the United Kingdom have implemented a *Digital Service Tax* (DST). Belgium, the Czech Republic, and Slovakia have published proposals to enact a DST, and Latvia, Norway, Slovenia, Russia and Denmark have announced their intention to implement such tax (Tax Foundation, 2021). In *America*, countries like Argentina, Costa Rica, México, Uruguay and Paraguay have introduced a DST, Canada announced its intention to introduce one, and Brazil has already drafted its proposal. In addition, *Asia* countries like Malaysia, Indonesia, Pakistan, Taiwan, Vietnam and India have enacted legislation to tax digital services, Thailand already has a proposal and Israel is considering it. Also, *Africa* countries like Nigeria, Kenya, Tunisia, Zimbabwe and Sierra Leone tax digital services and Egypt has the intention to implemented one. Finally, in the *Pacific*, a New Zealand DST may regain momentum if international progress stalls. Instead, countries like United States, South Africa, Switzerland, Sweden or Singapore are waiting for a global solution (KPMG, 2021).

Along with this confusing and diffuse panorama, some issues are still on the table. First, why the European OECD countries have not adopted yet the Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, or at best, what future awaits this proposal. Second, the OECD/G20 inclusive framework introduces proposals about "taxing rights allocation" and "taxing rights distribution", then, why the European Union Council has not yet adopted the Common Consolidate Corporate Tax Base (CCCTB) relaunched in 2016. Third, the OECD/G20 BEPS proposals are compatible with the *Global Intangible Law Tax Income* (GILTI) legislation introduced in the United States in December 2017 that some scholars see as the most significant tax code overhaul in over three decades?

## 4. CONCLUSION

The OECD, with the support of the G20, and the participation of the «inclusive framework» are approving a set of proposals that will change the global tax structure. The key issue on all this process is if the debates and decisions about the reform of the international tax architecture are legitimate and if the final result will be a fair and balanced distribution of taxing rights between developed and developing countries. To ensure wider and true participation of developing countries it would be good if other international and regional organizations could participate as well other independent or academic organizations.

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