

Taxation of the digitalizing economy

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FACTI ISSUES NOTE

The FACTI Panel published its [interim report](#) on 24 September 2020.

The FACTI Panel will hold a series of high-level virtual regional consultations with global stakeholders from 9 to 23 November 2020. The consultations aim to discuss possible means to address the shortcomings identified in the interim report. To orient the consultations a series of short issues papers are being presented along with guiding questions for the consultations.

INTRODUCTION

The international system has already recognised that digital technologies impact across all the SDGs and that existing policy and regulatory frameworks cannot deal effectively with the new realities of increasing digitalized economic activity. The digitalization of the economy is exacerbating concerns about a century-old system of international taxation that was already straining to accommodate the globalization of business and finance.

At the same time, technology can also enable better enforcement if the efforts are accompanied by constant vigilance of the financial system and adjustment of rules and regulations to match the innovations in the market.

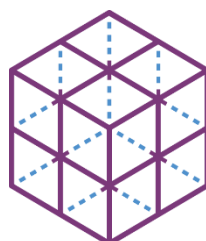
The growth of e-commerce and digital business models can disrupt different fiscal systems, including indirect and direct taxation. The increased supply of goods or services across borders has introduced challenges to collecting Value Added Tax (VAT) and goods and services taxes (GST). In relation to the taxation of multinational corporate profits, digitalization makes it easier to operate in a market without triggering tax residency rules. This is of particular concern for developing countries,

because they have lower tax administration capacity, less bargaining power against digital platforms, and a lower likelihood of physically hosting digital platforms.

Although major digital-economy multinationals may be among the most conspicuous in exposing the shortcomings of international tax norms, the same patterns of behaviour are seen, to varying degrees, among multinationals from all sectors. The professional enablers, including global law and accounting firms, are a key vector in promoting the spread of these behaviours.

There is broad consensus that the current international tax norms produce perverse effects when applied to digitalized business models. However, there is still no global consensus on how to address the tax challenges of digitalization of the economy, despite years of work in policy making forums.

Both the subcommittee on tax challenges related to the digitalization of the economy of the UN Tax Committee and the OECD Inclusive Framework have been considering what changes should be made, although it is the latter body that has so far set the agenda. Ahead of the Inclusive Framework meeting



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in January 2019, G24 members proposed a more radical set of reforms that were eventually taken forward. The Inclusive Framework discussion has been divided into two pillars.

The discussions in Pillar One focus on redistributing the tax base of digital and consumer-facing businesses within its scope towards the jurisdiction in which they have sales or users. The proposal seeks to make it harder for profits to be transferred to low-tax jurisdictions with little real activity. This includes recognition of the need to move beyond arm's length pricing and tax apportion some of the profits of some multinational groups based on a formulaic method. Pillar Two includes efforts that would ensure multinationals pay a minimum level of tax globally, addressing the transfer of profits to low-tax jurisdictions.

LOOKING FORWARD

In response to the increasing challenges of digitalisation, a number of emerging options

were presented to the Panel, as well as many possible venues and configurations for discussions. Some of these might inform the ongoing work at the UN Tax Committee towards a possible new treaty article responding to the challenges of digitalization. The Panel will pay special attention to what countries are, or could be, doing individually and through regional mechanisms of cooperation.

Guiding question for the consultations:

- **What are the effective international tax policy and institutional responses to address the questions of allocation of taxing rights in the context of digitalizing economies?**
- **Given the difficulty in agreeing multilateral solutions that are acceptable to all parties, how should States respond in the short- and medium-term to the increased digitalization of the economy?**

Further details on the high-level regional consultations can be found on the FACTI Panel website: <http://www.factipanel.org/events>.

