

Tax challenges, disruption and the digital economy

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The digital economy is a transformative process, brought about by advances in information and communications technology (ICT) which has made technology cheaper and more powerful, changing business processes and bolstering innovation across all sectors of the economy, including traditional industries. Today, sectors as diverse as retail, media, manufacturing and agriculture are being impacted in some way by the rapid spread of digitalisation. In the broadcasting and media industry, for instance, the expanding role of data through user-generated content and social networking have enabled internet advertising to surpass television as the largest advertising medium.



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In other words, “digitalisation” is pervasive, making it very difficult, if not impossible, to ring-fence the digital world from the rest of the economy, including for tax purposes. This is the first finding regarding the tax challenges of the digital economy agreed by all G20 and OECD countries, under the Base Erosion and Profit Shifting (BEPS) Project. BEPS refers to tax strategies that allow Multinational Enterprises to shift profits away from the locations where the actual economic activity and value creation takes place, into low or no-tax locations.

Action 1 in the 15-point Action Plan to address BEPS, the work on the tax challenges of the digital economy, aimed to consider whether the international tax rules were sufficient to meet the demands arising from new business models and ways of creating value that are emerging with the rise of new technologies.

While finding that the digital economy cannot be separated out from the rest of the economy, it was equally clear that some specific features of the digital economy may exacerbate the risks of base erosion and profit shifting for tax purposes—namely mobility (e.g. intangibles, business functions), reliance on data (and other forms of user input), network effects, and the spread of multi-sided business models.

Thanks to digitalisation, we now see businesses across all sectors having the capacity to design and build their operating models around technological capabilities, with a view to improve flexibility and efficiency and extend their reach into global markets. These advances, coupled with liberalisation of trade policy and reduction in transportation costs, have significantly expanded the ability of certain business models of the digital economy—e.g. electronic commerce, online advertising and cloud computing—to take advantage of BEPS opportunities. The techniques used to achieve BEPS by these businesses however, are generally not different from the ones used in other parts of the economy, and as such, countries agreed that the digital economy does not generate any unique BEPS issues, and that the solutions designed to tackle BEPS practices in the 14 other points of the BEPS Action Plan should suffice to address these concerns.

Second, beyond the issue of BEPS and tax avoidance, the key features of the digital economy raise more systemic challenges for tax policy makers that are generally grouped into three categories—the so-called “broader tax challenges”: (i) the difficulty of collecting VAT/GST in the destination country where goods, services and intangibles are acquired by private consumers from suppliers based overseas which may not have any direct or indirect physical presence in the consumer’s jurisdiction; (ii) the ability of some businesses to earn income from sales from a country with a less significant physical presence in the past, thereby calling into question the relevance of existing rules that look at physical presence when determining tax liabilities; (iii) the ability of some businesses to utilise the contribution of users in their value chain for digital products and services, including through collection and monitoring of data, which raises the issue of how to attribute and value that contribution.

On VAT/GST collection, the project resulted in international agreement on recommendations to allocate the collection of VAT on cross-border B2C supplies to the country where the customer is located. For the remaining two broader tax challenges, the continuing technological developments and business models—the Internet of things, robotics and the “sharing economy”, to name a few—may prove influential and disruptive in the near future, and accordingly, raise questions as to whether the existing paradigm used to determine where economic activities are carried out and where value is generated for income tax purposes continues to be appropriate.

It is still too early to determine whether these challenges are sufficiently critical in scale and impact to justify more fundamental changes of the existing international framework, beyond what is proposed in the package of measures to tackle BEPS endorsed by OECD and G20 in October 2015. Some potential options to address these challenges have been analysed, ranging from a withholding tax on digital sales to a new concept of nexus based on having a “significant economic presence”. In the coming years, the Task Force on the Digital Economy under the Committee on Fiscal Affairs will continue to monitor new developments—both in terms of technologies as well as new tax policy responses governments develop to address them, with a review of the 2015 report on BEPS Action 1 planned for 2020.

Needless to say, the stakes in this work are high, and so are the objectives: appropriate policy solutions need to be considered that address these challenges, even while the digital world continues to advance at an exponential rate. In a short period of time, it is possible that we may be confronted

with a fully-digital world that disrupts some of the fundamental assumptions of the international tax system.

OECD (2015), *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, <http://dx.doi.org/10.1787/9789264241046-en>

OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing, <http://dx.doi.org/10.1787/9789264202719-en>

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