STUDY

The Global Debate on Taxation in Digital Economy

State of Play and Implications for Developing Countries

The Global Debate on Taxation in Digital Economy: State of Play and Implications for Developing Countries

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Abbreviations

AI	Artificial Intelligence
ALP	Arm's Length Principle
ATAF	African Tax Administration Forum
BEPS	Base Erosion and Profit Shifting
B2C	Business to Consumer
CbC	Country by Country
CFA	Committee for Fiscal Affairs
CIT	Corporate Income Tax
DST	Digital Service Tax
DTA	Double Taxation Agreement
EU	European Union
EY/EYG	Ernst & Young Global
GAFA	Google, Apple, Facebook and Amazon
GVC	Global Value Chain
GAZT	General Authority of Zakat and Tax
GST	Goods and Services Tax
GloBE	Global Anti-Base Erosion Proposal
GCC	Gulf Cooperation Council
IoT	Internet of Things
ICT	Information and Communication Technology
ICTD	International Centre for Tax and Development
IF	Inclusive Framework

IP	Intellectual Property
LDC	Least developed country
MNEs	Multinational Enterprises
OECD	Organisation for Economic Cooperation and Development
OTT	Over the Top
PE	Permanent Establishment
PoW	Programme of Work
SEP	Significant Economic Presence
SIM	Subscriber Identity Module
UNCTAD	United Nations Conference on Trade and Development
UGX	Ugandan Shillings
U.S.A.	United States of America
USD	United States Dollars
USTR	United States Trade Representative
VAT	Value Added Taxe
WHT	Withholding Tax
WTO	World Trade Organisation
3D	Three dimensional

Abstract

The economy as we know it today is on the verge of transformation. Digital technology is penetrating every economic sector and every business, market and workplace. In the context of globalised economic activities and value chains, this accelerating digitalization comes with the challenge of taxing rapidly expanding online marketplaces and businesses without checks at physical borders. The existing tax legislations and policies are found more and more incapable of ensuring fair and effective taxation of companies and Multinational Enterprises (MNEs) who no longer need to establish "brick and mortar" companies and branches across borders to access markets and perform transactions. The key founding principles of the global taxation system and deriving regulatory frameworks are in question as they allow grey areas that larger MNEs, running digital businesses are able to exploit to shift profits and avoid taxes. Realising the large amounts of tax revenue losses resulting from these tax avoidance schemes and the even more significant losses that are expected if this situation persists, governments recently started taking actions towards ensuring fair and effective taxation of the digital economy at the multilateral level as well as at the national level.

At the multilateral level, the international tax system and regulatory frameworks have been so far developed through recommendations and soft laws advanced by the Organisation of Economic Cooperation and Development (OECD) and backed with recommendations from the United Nations Committee of Experts on International Cooperation in Tax Matters to ensure developing countries and LDCs special contexts and needs are taken into consideration. In 2013, the G20 and OECD jointly created the Base Erosion and Profit Shifting (BEPS) Programme to address the global taxation system shortfalls. In 2015, BEPS identified 15 Action-points – at the top being Action 1 "Address the Tax Challenges of the Digital Economy "- now subject to global discussions and negotiations. In 2016, it was decided to establish the BEPS Inclusive Framework and open the process and negotiations to non-OECD countries, thus, allowing developing countries to participate in the discussions originally set between a group of mostly developed countries.

With the BEPS Inclusive Framework, OECD is now leading a multilateral negotiation process aiming for a global solution for Action 1 by the end of 2020. Despite the OECD BEPS Inclusive Framework ongoing process of negotiations and OECD's advice against unilateral measures, many governments of both developed and developing countries found it difficult to wait years for a consensual solution to be reached and proceeded with exploring and adopting new tax measures and regulations addressing the digital sector and online businesses.

This study will give a panoramic view of the evolution of the debate on taxation of the digital economy. It aims to inform policy makers and negotiators of the developing and least-developed countries on the latest developments and status of multilateral level negotiations, as well as on types of the unilateral measures so far explored at the individual countries' level and their early impacts.

SECTION 1

Introduction

The fast-paced digitalization of the Economy and its implication on Tax governance

1. The transformative powers of the digital economy

The significant expansion of internet access and usage in the last two decades allowed digital data and technologies to infilter different aspects of economic activities. This "digitalisation" of the economy has been recently occurring at a remarkable pace, with the non-stop innovation in Information and Communication Technologies (ICTs) and their growing applications (i.e. artificial intelligence (AI), Internet of Things (IoT), automation, robotics, cloud computing, big data analytics, 3D printing… etc.). In such a context, the "Digital economy"[1] notion has re-emerged in the past few years and is currently frequently used to capture the transformations occurring as more and more services, products, manufacturing and production processes rely on ICTs and more and more value chains are digitally connected. (UNCTAD, 2019a; Hadzieva, 2019).

There are several attempts to define "digital economy" since the first use of the term in 1996. Bukht and Heeks (2017), enlisted the most significant definitions between 1996 and 2017. By examining them, they found that early attempts focused on the role of internet and on the development of ICT sectors. While later ones adopted wider views taking into account the ways the more digital technologies impact other traditional sectors (i.e. agriculture, tourism, trade, etc.) by creating new structures to support transactions and flows in business (i.e. digital services and platforms) and by stimulating new business models (i.e. e-business, e-commerce, industry 4.0, etc.). 'The digital economy under these definitions increasingly becomes just "the economy"' (Bukht and Heeks, 2017, p. 1) and no longer a separable part of the whole (UNCTAD, 2019a). This evolution in conceptualizing and perceiving the "digital economy" from a core scope focusing on ICT sector to a wide scope encompassing the whole economy is captured by UNCTAD (2017) in the below Figure 1 illustrating the architecture of the "digital economy".

[1] Don Tapscott is the first who coined the term "Digital Economy" in his article "The Digital Economy: Promise and Peril in the Age of Networked Intelligence", published in 1996.

Figure 1: Architecture of the digital economy

Source: UNCTAD (2017), p. 176.

The scale of and pace of digitalisation of the overall economy meant that its transformative trends (such as: platformisation, rise of digital content and data, e-commerce, etc.) are no longer confined to the geographical limit of developed countries but have a global reach. Developed and developing countries' governments, businesses and people are becoming increasingly concerned with how the digital economy operates, how it affects existing policies and what type of policies are needed to ensure seizing the opportunities it represents and respond to its associated risks and challenges (UNCTAD, 2019a).

2. The rising calls for fair taxation post-2008 financial crisis

The tax policy implications of digital economy have become a pressing issue of concern and debate whether at the domestic level or at the international level among governments, international organisations, businesses and civil society. Particularly since the financial crisis in 2008, more and more governments are interested in reviewing the existing tax governance system to ensure it fits the purpose in the emerging digitalised economic activities and businesses and helps increase fiscal income and reduce public debt. The Luxembourg Leaks (2014), Panama Leaks (2016) and Paradise Papers (2017)[2] have revealed aggressive tax avoidance

[2] A series of data leaks revealing financial scandals and tax avoidance schemes involving famous individuals and MNEs.

and tax evasion. schemes by Multinational Enterprises (MNEs) and increased pressures on governments to ensure fair and effective taxation. (Kurbalija, 2016; UNCTAD, 2019a; Terada-Hagiwara *et Al.*, 2019).

Data leaks and financial scandals also revealed highly digitalised business models and enterprises, exacerbate the risks of base erosion and profit shifting (BEPS) and adds to the challenges already faced by tax policies with the emergence of MNEs and global value chains (GVCs), especially with regard to determining the tax jurisdiction (Hadzhieva, 2019). In 2015, the OECD estimated that tax avoidance cost between USD 100-240 billion per year, or 4-10 percent of global corporate tax revenues (OECD, 2019a). In his keynote speech at the 'Masters of Digital' 2018 event in Brussels, commissioner Muscovici of the EU stated that in EU's single market 'domestic digitalised business models are subject to an effective tax rate of only 9%. This is less than half compared to traditional business models facing an effective tax rate of 21%'[3].

However, developing countries and least developed countries' (LDCs) concern with ensuring fair taxation, in the fast-growing digital economy, is greater than of developed countries. Developing countries and LDCs have greater needs for domestic resource mobilisation to finance their development, and rely more on corporate income tax (OECD, n.a.). Their losses are already high, as most of them do not physically host digital platforms (and are less likely to), and, while they remain net importers of digital services and goods, they contribute significantly to their user generated value. (UNCTAD, 2019a; UNCTAD 2019b). UNCTAD (2015) estimates $100 billion of annual tax revenue losses for developing countries due to tax avoidance schemes of MNEs. 'As the tax landscape evolves in the coming years, it is essential to ensure wide and more inclusive participation of developing countries in international discussions on taxation of the digital economy…' (UNCTAD, 2019a, p.XX).

3. The digital economy defies traditional taxation rules

The digital economy imposes new challenges related to the existing taxation system for MNEs, whether in terms of indirect taxes or direct taxes.

Direct Corporate Taxation

With regard to direct taxes the challenge is to attain the core principles of the taxation system. (OECD, 2019f). OECD has identified three main features of the digital economy and highly digitalised business models as the key challenges facing the conventional taxation system and questioning its fundamental rules, particularly those on 'the allocation of taxing rights between jurisdictions (the "nexus" rules) and on the determination of the relevant share of the MNE's profits that will be subject to tax in a given jurisdiction (the "profit allocation" rules)' (OECD, 2019b). The three features are detailed below.

Cross-jurisdictional scale without mass (also referred to as 'lack of nexus')

Internet and ICT has allowed businesses and corporates to locate different stages of their production processes across different countries (tax jurisdictions). Although this feature is not new, what is now exacerbating its impact on the taxation system is the fact that the growth and spread of digitalisation is now allowing enterprises to be heavily involved in the economy of a jurisdiction without significant or even any physical presence. In other words, it is possible for corporates to scale their business across borders without local mass (OECD, 2019b). This facilitates tax avoidance under the current nexus

[3] For the full speech, visit: http://europa.eu/rapid/press-release_SPEECH-18-981_en.htm

rules relying on physical Permanent Establishment (PE), as minimal profits could be attributed to such a nexus (Hadzhieva, 2019). This is particularly evident in e-commerce and cross-border trade in services and digital products. Many sellers avoid registration in third states, where they conclude transactions via platforms. (UNCTAD, 2019a).

Reliance on intangible assets, including intellectual property (IP).

Digitalised enterprises and business models rely heavily on intangible IP assets, such as source codes, software and algorithms which analyses large amounts of data. Those are becoming the key assets in digitalised businesses. Such non-physical assets make it easier for companies to structure themselves in a way that minimises their tax liabilities (Hadzhieva, 2019). For example, in technology companies 'IP is often developed initially in one country and transferred offshore for future development in a tax-advantaged jurisdiction, while being commercialized in products and services that are sold in markets around the world' (EY, 2015, p.4). In such a pattern, tax authorities face difficulties to assess fairly how resulting profits should be identified, valued and allocated to the different jurisdictions of an MNE. (Hadzhieva, 2019).

Data, user participation and their synergies with IP

This stems from the increased user contribution to economic value through the provision of data. New business models increasingly rely on Data originally provided by users and customers. Through data analysis, companies are more and more able to derive benefits from customers' collected information (OECD, 2019b). Advertising on social networks is a clear example that 'raises the question on whether the users contribute to value creation by providing their data to platforms in exchange for free access (which is then sold to online advertisers by platforms) in addition to enlarging the user base of the platform and enhancing its reputation through network effects' (Hadzhieva, 2019, p.17).

The proliferation of corporate BEPS schemes also affects indirect tax, as it may lead government to raise their VAT rates to compensate their revenue losses. This creates even more pressure on politicians to 'justify why consumers were paying higher VAT rates, while businesses were paying less and less tax while exploiting more and more loopholes.' (Hadzhieva, 2019, p.92).

Indirect Taxes on consumption and the rise of remote supply of intangible products and services

As for indirect taxes, they represent a major source of revenue for states. With less revenues from corporate taxes, politicians are also under pressure to try to protect indirect tax revenues. But Digitalisation is also altering traditional Business to Consumer (B2C) trade relations with the fast-growing e-commerce and online selling of goods and services through digital platforms. 'The value of digital trade is estimated to rise to about USD 1 trillion by 2020, reaching one third of all Business to Consumer (B2C) transactions worldwide' (Hadzhieva, 2019, p.90). This poses significant challenges to the imposition of indirect taxes represented in Value Added Taxes (VAT), also called Goods and Services Taxes (GST). especially when it comes to their collection.

Today customers can shop from non-resident suppliers falling outside the consumption tax jurisdiction. This trend challenges the historical VAT system based on the residency of the supplier, as in traditional commerce the supplier is assumed to be residing in the same country as the customer. Online platforms like eBay and Alibaba, acting as intermediaries or third party market place connecting buyers and sellers (for example, do not own or sell goods but merely connect buyers and sellers), raise questions on

who would be liable to collect taxes for the sold goods and services (Ibid, 2019).

The emergence of new technologies and the acceleration of cross-border trade of intangible products and services also cause doubts and uncertainties to arise with regard to where the value has been created and who should carry the burden of VAT. Taking 3D printing as an example, the final product could be produced at the buyer's premises, while the design has been made in another jurisdiction. Technology and online trade have also made VAT fraud actions and mechanisms easier and less detectible as high-tech financial and accounting software can be cracked (Ibid, 2019).

The above key features of the digital economy and their evolving business models and trade practices revealed shortcomings of the existing tax system in the digitalised economy where the relation between value creation and profit allocation is no longer linear. And in the years following the 2008 financial crisis, they resulted in a growing consensus among countries with regard to the need to reform the system to close loopholes in nexus and profit allocation rules and ensure efficiency and fairness. Despite this growing consensus, the scope and breadth of reform remain highly debatable (Terada-Hagiwara *et Al.*, 2019; UNCTAD, 2019a).

The different views to taxation reform in digital economy:

Two main approaches can be observed with regard to the scope of tax challenges of the digital economy and to the scale of the needed reforms:

- The first approach is mainly attributed to the EU and European countries. It considers the misalignment between the jurisdiction where value is created and the jurisdiction where profits are taxed that is not due to defiance of the whole existing taxation system and to BEPS practices, but due to the emergence of new and unique features confined to highly digitalised business models. They believe reforms in the existing tax system, including a reconsideration of profit allocation and nexus rules, should target highly digitalised business models and enterprises only (OECD, 2018). They support the approach of a 'digital tax', that targets large, cross-border digital companies (those are largely either of the U.S. or China), to be imposed by countries where those companies serve numerous customers, while having a limited or no PE (Bräuninger, 2019).
- The second approach is attributed mainly to the U.S. who takes the view that the challenges to the existing tax system is more generally caused by globalisation trends and cannot be exclusively attributed to the highly digitalised industries and business models of the economy (OECD, 2018). As a matter of fact, the U.S. since it adopted the Internet Tax Freedom Act in 1998, has been advocating for declaring the internet and transactions over it as a tax-free zone. In 2016, a legislation was passed in the U.S. that permanently bans states and local governments from taxing Internet access. It also bans some taxes on digital goods and services. As cross-border e-commerce and transactions have been growing significantly, the U.S. has been more in favour of moving from the currently established principle of VAT taxation 'based on destination' where consumers reside to taxation 'based on origin' of the supplied good or service (Kurbalija, 2016).

Together, the G20 and the OECD announced the BEPS project outlining 15-point Action Plans[4] to counter BEPS in 2015. The BEPS project was open for non-OECD members to join through the

[4] For more information on the 15-point Action Plan, visit: http://www.oecd.org/tax/beps/beps-actions/

establishment of the Inclusive Framework on BEPS in 2016. Thus, the OECD is now leading global discussions with the aim to generate a consensus-based solution to challenges facing the current taxation system, while giving priority to the tax challenges of the digital economy under Action Plan 1 (Section 2). In the meantime, several developed and developing countries decided to explore unilateral domestic tax measures (Section 3). This study aims to explore those different tracks for addressing the tax challenges of the digital economy and their implications for developing countries.

SECTION 2

OECD and G20 Leading global negotiations for a consensus-based solution to tax challenges of the digital economy

1. OECD Ottawa Ministerial 1998: E-commerce Taxation follow broad traditional taxation principles

Tackling the rise of digital economy and of new e-commerce business implications on taxation policies in the OECD is not recent. In October 1998, the OECD organised its Ministerial Conference on the theme of "*A Borderless World: Realising the Potential of Electronic Commerce*" in Ottawa. This event was the first to tackle e-commerce under the OECD and witnessed the establishment of the OECD work programme on e-commerce. Ministers also adopted a report prepared by the Committee on Fiscal Affairs (OECD-CFA) which sets out *Electronic Commerce Taxation Framework Conditions*. The report stated that the principles adopted by OECD for the taxation of traditional commerce, should apply to the taxation of e-commerce as well (OECD, 1998). Box 1 below sets out the OECD general tax principles that should remain applicable to electronic commerce.

Box 1. OECD Ottawa Ministerial Broad Taxation Principles

(which should apply to electronic commerce)

'Neutrality: (i) Taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce. Business decisions should be motivated by economic rather than tax considerations. Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.

Efficiency: (ii) Compliance costs for taxpayers and administrative costs for the tax authorities should be minimised as far as possible.

Certainty and simplicity: (iii) The tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction, including knowing when, where and how the tax is to be accounted.

Effectiveness and Fairness: (iv) Taxation should produce the right amount of tax at the right time. The potential for tax evasion and avoidance should be minimised while keeping counter-acting measures proportionate to the risks involved.

Flexibility: (v) The systems for the taxation should be flexible and dynamic *to ensure that they keep pace with technological and commercial developments.'*

Source: OECD (1998), p. 4. Available at http://www.oecd.org/ctp/consumption/1923256.pdf

2. Addressing tax challenges of digital economy: Progress under OECD/G20 BEPS Project

Since 1998, and as per the context described in the introduction, digitalised business models and MNEs have been on the rise, so has been aggressive tax avoidance schemes. Also, tax disputes have become more complex. They revealed the limits of the existing tax rules and the divergence of views with regard to how to transcend those limits. In February 2013, the OECD released the report *Addressing Base Erosion and Profit Shifting*. Following that, OECD and G20 countries agreed to address the issue of tax avoidance and BEPS schemes through a series of 15 action plans detailed in 2015 (OECD, 2015). In 2016, it was decided to have non-OECD countries joining the process, thus OECD/G20 Inclusive Framework (IF) on BEPS was inaugurated in July 2016 in Kyoto, Japan with the presence of 82 member countries. The IF now comprises over 135 members and 14 observer organisations (OECD, n.a.). Thus, it is leading global negotiations for consensus-based solutions to BEPS, while prioritizing *Action Plan 1: Addressing the tax challenges of the digital economy* (UNCTAD, 2019; Hadzhieva, 2019).

It was clear from the description of Action 1 (See Box 2 below) and its first detailed report in 2015, that while indirect taxes, represented in VAT/GST, are affected by the rise of the digital economy particularly when it comes to Governments' ability to collect them, their core principles remain widely accepted and not questioned. Unlike the case of income taxes levied at the place or residency of the source of income, there is a 'widespread consensus' that VAT follows the 'destination principle' by being levied at the final consumer jurisdiction (the importing country). It has been found that the destination principle helps realise neutrality in the international trade. OECD 2015 report explains that in the destination principle 'exports are not subject to tax with refund of input taxes (that is, "free of VAT" or "zero-rated") and imports are taxed on the same basis and at the same rates as domestic supplies' (OECD, 2015, p.12).

Box 2. OECD/G20 BEPS Action 1 – Address the tax challenges of the digital economy

'Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location relevant data through the use of digital products and services, the characterisation of income derived from new business models, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services. Such work will require a thorough analysis of the various business models in this sector'.

Source: OECD, 2015, p.16.

The other option is applying the 'origin principle', where each jurisdiction would levy VAT on the value created within its own borders and imported services are not subject to VAT in the consumer's jurisdiction. But under the origin principle, neutrality of the international trade system can be undermined as it creates an incentive for suppliers to divert their activities to jurisdictions where no or a low VAT is applied and to sell remote services into foreign markets VAT-free or at a low VAT rate. (OECD, 2015) This explains why the 'destination principle' is endorsed by the World Trade Organisation (WTO), as it does not

consider exempting an exported product from tax or duties or applying a lower tax rate for it compared to a like product for domestic consumption, as a subsidy[5].

Therefore, with regard to the challenge of collecting VAT/GST in the digital commerce, the OECD has simply recommended to follow the destination principle and the recommendations of the *OECD's VAT/GST Guidelines (2015)*[6], which suggests that the supplier registers, collects, and remits VAT to the customer jurisdiction. Recognizing the specific challenge of collecting taxes as per the destination principle in the digital economy, the OECD produced a report on *Mechanisms for the Effective Collection of VAT/GST When the Supplier Is Not Located In the Jurisdiction of Taxation (2017)*[7], to serve as a guide for countries when reviewing their collection mechanisms and policies.

As for direct corporate income tax, the situation is more complex as the challenges touched upon traditional elements of the tax system and the suggested solutions varied in scope. Thus, more efforts were required to facilitate consensus. In January 2019 the OECD-IF published a policy note that divided proposed solutions, under Action Plan 1, into two pillars (see below section 2.3): the first is more controversial and aims to revise nexus and profit allocation rules, while the second envisages a minimum level of tax on digital MNEs as a global measure to counter remaining BEPS risks and practices in digital economy from a more general perspective (OECD, 2019b; OECD, 2019d). In March 2019, a public consultation document, outlining the two pillars and the related proposals, was published. Following a series of public consultations and events with representatives from academia, businesses and civil society, the OECD/G20 IF adopted, on 28-29 May 2019, a *Programme of Work (PoW) to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy*. This was endorsed by the G20 Finance Ministers and Leaders in June 2019 (OECD, 2019f).

In an effort to bring closer the various proposals and approaches for pillar 1, the May PoW outlined those various proposals and noted the commonalities and differences between them. It also set January 2020 as a deadline for reaching outlines for a unified approach under this pillar in order to be able to meet the end of 2020 deadline for a consensus-based solution (OECD, 2019f). Thus, the OECD Secretariat developed a "Unified Approach" proposal for Pillar 1 to facilitate progress towards consensus and released it to the public for comments on 9 October 2019 (OECD, 2019g). After public consultations, the OECD/G20 BEPS IF released a *Statement on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy* on 29-30 January 2020. In the statement, the IF announces taking the Secretariat "Unified Approach" forward as the basis for the negotiation of Pillar 1 with the aim to reach a consensus-based solution by mid-2020. The statement included a revised PoW for Pillar 1 outlining the remaining work to be accomplished by the end of 2020. It also outlined progress achieved on Pillar 2 encompassing a Global Anti-Base Erosion Proposal (GloBE) (OECD, 2020a).

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[5] Footnote 1 of the WTO's Agreement on Subsidies and Countervailing Measures provides that "… *the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy*."

[6] The guide is available here: https://www.oecd.org/tax/consumption/international-vat-gst-guidelines.pdf

[7] The report available here: http://www.oecd.org/tax/tax-policy/mechanisms-for-the-effective-collection-of-VAT-GST.pdf

3. The OECD Two Pillar Approach Proposal: The base for negotiation in 2020

Pillar 1 (re-allocation of taxing rights):

This pillar seeks solutions for determining the allocation of taxing rights, including nexus issues. Several proposals have been made by IF members on a without prejudice basis, these are:

- **User participation proposals:** recognise the value created by users of digital services (applicable to highly digitalised businesses like social media platforms, search engines and online marketplaces);
- **marketing intangibles proposals:** recognise the value created by the market country (applicable to all businesses) and
- **significant economic presence (SEP) proposals:** (applicable to all businesses) which participate in the economic life of a jurisdiction without having a physical presence (OECD, 2019d; Deloitte, 2019a; Deloitte, 2019b).

Despite the differences in scope and approach, the OECD secretariat identified commonalities between the proposals as follows: i) they intend to reallocate taxing rights in favour of the user/market jurisdiction; ii) they establish a new nexus rule that no longer depend on physical presence; iii) they all deviate from the arm's length principle (ALP) [8] that OECD member countries have agreed should be used for tax purposes by MNE groups and tax administrations and iv) they all aim to increase certainty and simplicity when implementing tax rules (OECD, 2019g). Based on the enlisted commonalities, the OECD Secretariat proposed an outline for a "Unified approach" which BEPS IF decided to take further as basis for negotiations starting the end of January 2020. (OECD, 2020a).

The proposed "Unified Approach" currently base for negotiation includes a three-tier mechanism for profit allocation (see figure 2 below):

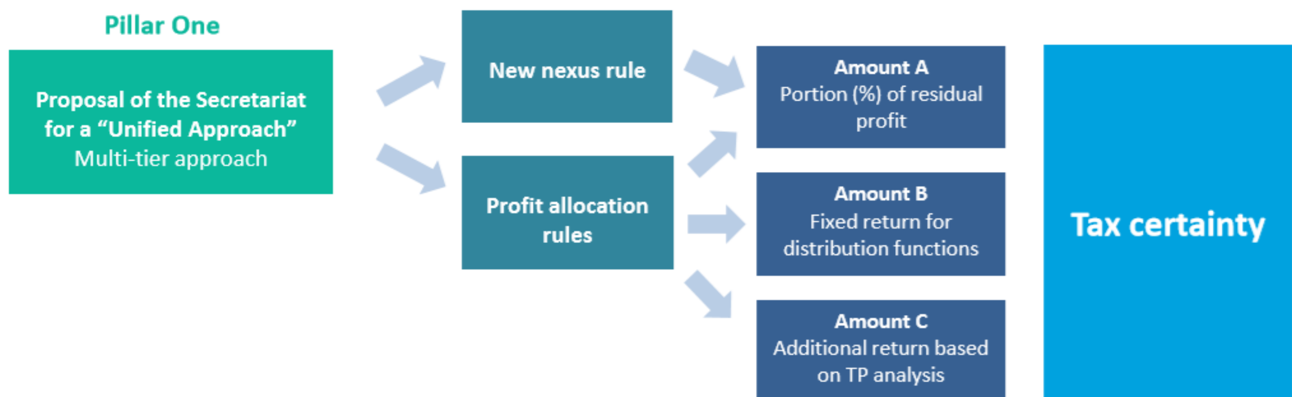
- **Amount A – new nexus and taxing right (See figure 3 below)** – allocates a share of residual profit to market jurisdictions using a formulaic approach applied at an MNE group (or business line) level. It consists of a new taxing right and creates a new nexus irrespective of physical presence. The businesses falling under its scope will be the ones falling into at least one of the following two categories: Automated digital services and consumer facing businesses (OECD, 2020a). '*It reflects profits associated with the active and sustained participation of a business in the economy of a market jurisdiction, through activities in, or remotely directed at that jurisdiction, and therefore constitutes the primary response of the unified approach to the tax challenges of the digitalisation of the economy*' (Ibid, p. 8).
- **Amount B** – it aims to reduce disputes and achieve greater certainty by applying a fixed remuneration for tax purposes for baseline or routine marketing and distribution activities that take place in the market jurisdiction (OECD, 2020a; OECD, 2019e).
- **Amount C** – Retains market jurisdiction right to tax profit above baseline activity compensated under Amount B and

[8] A valuation principle, commonly applied to commercial and financial transactions between related companies (for example exchanges of goods and services between MNEs and their subsidiaries) says that transactions should be valued as if they had been carried out between unrelated parties, thus according to market prices and rules.

introduces effective dispute prevention and resolution mechanisms relating to all elements of the proposal. (OECD, 2020a; OECD, 2019e).

Unlike Amount A, Amounts B and C do not create any new taxing rights. They follow the existing profit allocation rules (including the reliance on physical presence). They also continue to follow the ALP with the aim to improve its application. (OECD, 2020a; OECD, 2019e).

Figure 2: Proposed Unified Approach under Pillar 1



Source: OECD, 2020b.

Figure 3: Amount A: New Taxing Right

Step 1: Determination of total profit
- MNE group or business-line calculations

Step 2: Exclude "deemed" routine profit to defin
- Profitability threshold (i.e. fixed percentage(s))

Step 3: Allocate a portion of "deemed" residual p
- Formulary (i.e. fixed percentage(s))

Step 4: Allocate the relevant portion of the deem residual among market jurisdictions
- Agreed allocation key (e.g. sales)

Source: OECD, 2019e.

Pillar 2 (the Global Anti-base Erosion Proposal - GloBE)

Unlike Pillar 1 where there were competing proposals requiring work to bring them under a "Unified Approach", the key elements of Pillar 2 were already set since the PoW adopted in May 2019, the work remaining only to explore the various possible design options and discuss an optimum choice (OECD, 2020a). As more and more countries are conducting tax policy reforms and imposing new policy rules and measures to address BEPS risks and avoid the under-taxation or non-taxation of MNEs and digital platforms using their markets to buy and sell their products, this pillar proposes, on a non-prejudice basis, the design of a system to ensure MNEs pay a minimum level of tax by allowing jurisdictions to tax profits where the other jurisdiction with taxing rights applies a low effective rate of tax. Its primary objective is to deal with a "jungle" of new uncoordinated tax policies and to contain the risk of over-taxation. (OECD, 2019d; OECD, 2019e).

GloBE comprises of four components that can be combined forming different policy designs:

- **an income inclusion rule:** It requires a foreign corporation (the parent corporation of an MNE) to bring into account the proportionate share of the income of that corporation if that share of income was not subject to an effective rate of tax above a minimum rate at the subsidiary jurisdiction. In other words, it allows to top up tax to that minimum rate, which is still subject to discussion with the objective of coming up with a fixed percentage. It would ensure that the income of the MNE group is subject to tax at a minimum rate thereby reducing the incentive to allocate income for tax reasons to low taxed entities.

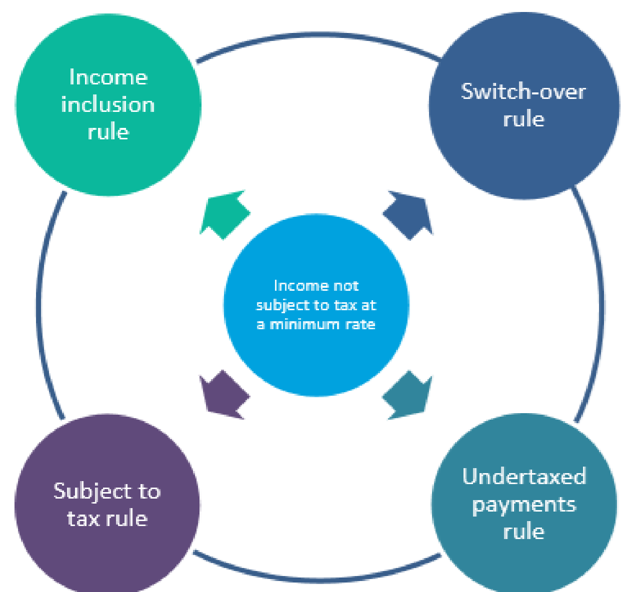
- **undertaxed payments rule:** operates by denying a deduction or by imposing an adjustment in respect of intra-group payments whereby payment to a related party was taxed below a minimum rate;

- **a switch-over rule** applies only where countries have committed to use the exemption method in their tax treaties. It allows a residence jurisdiction to switch from an exemption to a credit method where the profits attributable to a PE in another jurisdiction or derived from immovable property (which is not part of a PE) are taxed below a minimum effective rate;

- **a subject to tax rule** subjects an intra-group payment to withholding or other taxes at source and adjusts eligibility for treaty benefits on certain items of income where the payment is not subject to tax at a minimum rate (OECD, 2020a; Rukundo, 2020).

These rules are still under examination as their implementation would require amendments to domestic tax law, as well as to international tax treaties. Further work is undertaken to ensure coordination and compatibility with international obligations (OECD, 2020a). A high degree of coordination and of ordering of these rules is needed to ensure double taxation risk is avoided. (Rukundo, 2020). Worth also mentioning that work under Action Plan 13 of the BEPS project is closely related as it sets a revenue threshold for MNEs. Beyond the identified threshold, MNEs will be required to prepare a country-by-country (CbC) report with aggregate data on the global allocation of income, profit, taxes paid and economic activity among tax jurisdictions in which it operates. The threshold has been set at a combined revenue of 750 Million Euros for the MNE group. Which means that MNEs with a combined revenue less than the 750 Million Euros will not be subject to GloBE rules (OECD, 2020a).

Figure 4: GloBE Proposal Components



Source: OECD, 2020b

4. OECD BEPS negotiations from developing countries' perspective

It is important to grasp the nature of international tax rules system, in order to be able to evaluate the OECD BEPS IF process and what it can bring to the developing countries. The international tax system consisted so far of soft laws and recommendations developed by the OECD: those are then adapted by the United Nations Committee of Experts on International Cooperation in Tax Matters to fit developing countries' needs. That soft law becomes hard law only when countries either chose to follow them by developing relevant domestic laws, or when conducting bilateral treaties that incorporate OECD and UN recommendations (Hearson, 2020). With the creation of the OECD BEPS IF, the institutional setting is changing as now developing countries are included in the OECD discussions and get to advance their interests in the discussions. But on the other hand, the OECD process is leaning more and more towards 'harder' law (Ibid, 2020). The Statement of end of January 2020, by the OECD/G20 IF on BEPS advancing the Two-Pillar Approach proposal for negotiation mentions that 'It is expected that any consensus-based agreement must include a commitment by members of the Inclusive Framework to implement this agreement and at the same time to withdraw relevant unilateral actions'.

It is worth noting that allowing developing countries to join the process is not enough to consider BEPS negotiations and outcomes as 'inclusive'. What matters more is whether the process takes on board the special interests of the developing countries and gives them the capacity to have a say (UNCTAD, 2019; Hearson, 2020). While the IF, allowing non-OECD members to participate in the discussions was created in June 2016, the BEPS project action plan and proposed solutions were already agreed in 2013 by OECD members and the G20, and developed in 2015. In other words, whatever solutions are subject to negotiations at the moment, were originally designed by developed countries and reflect interests of developed countries, which in the context of the growing digital economy, are widely different than those of developing countries, particularly lower income countries and LDCs (UNCTAD, 2019). Chowdhury (2019) in his article published by the Independent Commission for the Reform of International Corporate Taxation (ICRICT), undermines the credibility of the OECD to undertake such negotiations for those reasons: 'WHILST the institutional framework has been made more inclusive by including developing countries, the credibility of OECD as the appropriate body to continue to lead this work remains in question, and much still needs to be done to ensure effective participation and representation of developing countries'.

In its media statement on the outcomes of the IF meeting of 29 to 30 January 2020, the African Tax Administration Forum (ATAF)[9] expressed its concerns that: 'the political and technical complexities of the Inclusive Framework proposals and the timing of the process that aims for a global agreement by the end of 2020 means it is extremely challenging for many of our members to fully participate in the Inclusive Framework process and to ensure the new rules are fit for purpose for African countries. We are concerned that these complexities may mean some countries may commit to new rules without a full understanding of the revenue and investment implications for them'. Not to mention that, the implementation of the proposals will require significant resources especially trained staff, as well as access to financial information of

[9] The African Tax Administration Forum is an organisation which was established by African revenue authorities in 2009, in order to improve the performance of tax administrations in Africa. The tax administrations of 38 countries in Africa are members of ATAF, i.e. 75% of tax administrations on the continent.

MNE groups and parent companies, which is more challenging to developing countries compared to developed countries. Currently, developing countries can only have access to MNE activities in their own country which is not enough for revenue authorities to determine the value creation in their markets (Hearson, 2020).

As for the proposals, despite the enthusiasm surrounding them, especially on the first pillar and Amount A, as it actually touches upon the core established foundations of the taxation system, whether this proposal and others will allow developing countries generate more tax revenues or not will depend on many factors that remain unresolved, like the formulas and the thresholds. However, for lower income developing countries who have limited market shares in highly digitalised businesses, it is highly unlikely they will be able to reap benefits with such a solution, especially that it carves out other Multinationals with large market shares in those countries, like extractive companies (Hearson, 2020). The latest suggestion by the U.S. to adopt Pillar One on 'safe harbour' basis, which gives MNEs a way out of being subject to the new nexus and allocation of profit rule, raises doubts that an agreement on Amount A is possible by end of the year. And if U.S. suggestion is adopted, then Amount A becomes useless (AFTA, 2020). On the other hand, it is Amount B that can be of more interest to developing countries, despite the fact that it still depends on PE, but it helps limit MNEs manipulation of the profits of their subsidiary and distribution companies operating in developing countries, reduce disputes and increase tax revenues (Hearson, 2020; AFTA 2020).

Finally, although the whole process of BEPS has a clear objective to restrain countries from adopting uncoordinated unilateral measures, more and more countries, whether developed or developing countries, introduced or are considering unilateral measures and national tax policies reform in the recent years, to counter BEPS and to address the challenges of the digital economy. The following section will give a panorama of these measures and highlight some lesson learned for developing countries.

SECTION 3

Recent Unilateral Tax Measures: Best Practices and Lessons Learned

1. Unilateral Measures: Not favoured, but necessary...

According to the UN Committee of Experts on International Cooperation in Tax Matters (2017), a unilateral tax measure consist of 'any individual country attempt to capture "rents" (i.e. through the application of direct and indirect taxes) deriving from a digital activity without engaging into the renegotiation of a bilateral tax treaty, or without the need for consulting comprehensively with other countries. It is characterized by the adoption of new tax laws, or the re-interpretation of existing domestic laws or treaty provisions to adapt to an increasingly digitalised and globalised way of doing business. It is a "bottom-up" approach initiated by the countries, as opposed to a "top-down" approach or facilitated by, an international institution although such bodies can play a key facilitating role in ensuring an interplay between bottom-up and top-down approaches to dealing with novel challenges and in reducing the number of approaches, as well as promoting transparency on unresolved differences'. In line with this view, concerted measure can be preferred when dealing with global emerging challenges, in the sense that they help prevent a race of uncoordinated unilateral actions 'undermine the relevance and sustainability of the international tax framework, and would damage global investment and growth' (OECD, 2019g, p.4).

But in a post-2008 financial crisis context countries are less tolerant to losing tax revenues due to existing tax measures loopholes and increased inadequacy to the rising digital economy era. Tax revenues have always been a vital component of public expenditure, whether for developed countries or developing countries. One can argue that tax revenue is of greater importance to developing countries as it is considered a source for financing long term development policies in areas like infrastructure, health and education. The lack of international consensus on taxation issues in the digital economy since the creation of BEPS in 2013, followed by the creation of the Inclusive framework in 2016 and the slow progress on conflicting issues, has led many countries to decide to enact their own tax reform processes and to adopt legislations and measures that respond to the challenges described in section 1 (UN Committee of Experts on International Cooperation in Tax Matters, 2017).

Valdis Dombrovski, the vice president for euro and social dialogue, summed up the situation as he was justifying the EU commission's announcement of a proposal for new European corporate taxation rules; he said: 'We would prefer rules agreed at the global level, including at the OECD. But the amount of profits currently going untaxed is unacceptable. We need to urgently bring our tax rules into the 21st Century… ' (EU Commission, 2018).

Developed countries were the first ones to initiate unilateral actions to address taxation challenges of the digital economy. (UN Committee of Experts on International Cooperation in Tax Matters, 2017). In fact, the OECD BEPS project emerged in response to unilateral measures taken by member countries of the OECD and G20 (Hearson, 2020). If developed countries felt the urge to act upon tax challenges, it was only a

matter of time for developing countries to start picking up on the trend and explore policy responses to the transformative effects of digitalisation, especially when 'they are at an inevitable structural disadvantage in global negotiations' (Hearson, 2020, p. 11).

2. Indirect tax measures targeting the digital sector

Imposition of new VAT/GST on digital products and services provided by suppliers from abroad

The global digital products and services market has become dominated by a number of large digital platforms capable of using tax optimisation techniques that allows them to shift profits to low tax jurisdictions. For example, in 2017, although Facebook earned 56 per cent of its revenue and 66 per cent of its profit outside the United States, it paid 92 per cent of its taxes in the United States (UNCTAD, 2019a, p.95). In that context, more and more governments (whether of developed or developing countries) are levying VAT or GST taxes to capture services and products provided over the Internet by suppliers from abroad, due to their relatively easy imposition and their low perception costs (Hadzhieva, 2019). The following table (Table 1) gives an overview of some of the countries who imposed in recent years VAT/GST on sales, consumption or use of digital goods and services supplied by non-resident digital MNEs and platforms.

Table 1: Selection of key tax jurisdictions where digital VAT/GST tax were imposed

Country	Effective date	Brief Description	OECD guidance
Developed Countries			
Norway	January 1, 2011 January 1, 2020 April 1, 2020	Norway requires non-resident vendors of digital services to consumers in Norway to register for and collect VAT at a 25% rate. The NOK350 low-value import VAT exemption threshold is being removed in two stages in 2020: i) Effective January 1, 2020, the threshold is removed for all food and beverages, restricted goods such as endangered animal species, certain chemicals and medicines, and certain other taxable goods, such as motor oil. ii) Effective April 1, 2020, the threshold is removed for other goods, including clothing, shoes, and electronics. Non-resident vendors (or the online platforms through which the sales are performed) of goods value less than NOK 3,000 are required to register for and charge VAT on such sales.	Yes
Australia	July 1, 2017 July 1, 2019	Australia requires non-resident vendors of digital services to consumers in Australia to register for and collect GST. Offshore sellers of Australian hotel accommodation are required to charge GST in the same way as local sellers.	Yes

Singapore	January 1, 2020	Singapore requires non-resident vendors of digital services to consumers in Singapore to register for and collect VAT at 7% rate.	Yes
United States	September 1, 2019	Remote sellers are required to collect and remit tax on sales made to in-state customers if they meet the state specified sales thresholds (often $100,000 in sales or 200 transactions). Economic nexus rules affect all companies exceeding the state-specific sales threshold, including those not resident in the U.S. Additionally, about 35 states require electronic marketplaces[10] (Third party platforms like Amazon and e-Bay) that meet the specified sales threshold to collect tax on sales they facilitate.	Yes
Developing countries			
Brazil	April 1, 2018	State VAT on digital goods, such as apps, e-books, software, games, etc. The tax is paid in the state where the download or streaming is conducted and where the purchasing consumer is located. (Sao Paolo, Paraiba, Goias, Piaui e Rondonia are only states having introduced rules).	N/A
Cameroon	N/A	According to a newly introduced 2020 Finance law, the sales of goods and services to businesses (B2B) or individual customers (B2C) in Cameroon through foreign or local e-commerce platforms shall be liable to VAT. A yet to be published circular will provide the application in details.	No
India	December 1, 2016	India requires non-resident vendors of digital services to consumers in India to register for and collect service tax. These rules were continued under new GST regime effective July 1, 2017. GST rate is at 18% for digital services.	Yes
Malaysia	January 1, 2020	6% sales and service tax on digital services provided by foreign companies from January 1, 2020. Foreign service providers are required to register for digital tax if their total annual fees received from Malaysian customers exceeds RM 500,000. Digital services include software, music video, and digital advertising. According to the Service Tax Guide on Digital Services, the provisions of digital services are applicable to both business-to-business (B2B) and business-to-consumer (B2C) transactions.	No
Saudi Arabia	January 1, 2018	In February 2017, Saudi Arabia ratified the Gulf Cooperation Council (GCC) VAT framework and committed to introduce VAT at 5%, while requiring non-resident vendors of digital services to consumers in Saudi Arabia to register for and collect VAT. The General Authority of Zakat and Tax (GAZT) is responsible for managing the implementation, administration and enforcement of VAT in Saudi Arabia.	Yes

Source: Prepared by the author based on information from KPMG, 2020 and Taxamo, 2020.

[10] Generally, a marketplace is defined as an entity that advertises products for sale by others and that collects payment from the customer, but state definitions differ.

Taxes on social media and mobile applications in Africa

Taxes targeting users of social media and mobile applications have been recently of particular interest to African countries representing emerging markets where millions of people are coming to the internet for the first time (Rukundo, 2020). UNCTAD 2019a projects that the highest growth rate in data traffic over the period of 2017-2022, will be at 41 percent in the Middle East and Africa, followed by Asia Pacific at 32 per cent (UNCTAD, 2019a). The year 2018 was marked by consecutive decisions to impose taxes for the use of "over the top" (OTT) [11] mobile communication apps and social media sites (such as: WhatsApp, Facebook, Skype… etc.) by three African governments, namely: Uganda, Zambia and Benin (Rukundo, 2020). 'The chief justification was that many taxes on phone calls were no longer effective because many people have started using mobile applications for communication (Ibid, 2020, p. 17).

Uganda was the first, as the government imposed in July 2018, a daily excise duty charge of 200 Ugandan Shillings (UGX) (USD 0.053) to use of any one of 58 OTT Apps. The Ugandan taxed the use of mobile money, a key method for Subscriber Identity Module (SIM) cards top-up in the country, at a rate of 1% (Mozilla Foundation, 2019). Following Uganda, Zambia, in August 2018, imposed a 30 Ngwee or Zambian Kwacha (USD 0.03) daily tariff on internet voice calls as the government considered it a threat to the telecommunications industry. And in September 2018, Benin introduced a tax at the rate of 5 CFA Francs (XOF) (USD 0.008) per megabyte of data while using OTT apps, but withdrew it five days after the announcement due to protests. (Rukundo, 2020).

These excise duties can raise public revenues particularly in countries where the number of users is expected to increase with significant rates. For example, the Ugandan tax raised 14 million USD in its first year (Rukundo, 2020). However, they have an adverse effect. They lead to raising the prices of the subject goods or services relative to others and eventually suppressing their consumption (Ibid, 2020). According to Mozilla Foundation (2019), only six months after the tax was introduced, national internet usage rates dropped from a rate of 47.4% to 35%, which in return led to a backdrop in the tax revenues. 'Excise duties are therefore usually confined to goods and services that are both price inelastic and have negative externalities, such as alcohol, tobacco, and petroleum products. Services like social media and mobile applications are therefore ill-suited for excise duties' (Rukundo, 2020, p. 17-18).

Also, the analysis of African Mobile Network Operators shows that 'most operators have experienced strong revenue growth due, in part, to an OTT-induced increase in data revenues in the past five years. Data revenue growth outpaces potential decreases in voice and SMS revenues. That declining revenues of a subset of operators are due to insufficient 3G or greater network coverage, excessive regulation and/or adverse economic conditions' (Stork and Esselaar, 2019, p.7). In other words, upgrading telecommunications services and ensuring measures do not affect the growth of digital economy are capable of inducing better returns for those countries.

[11] An over-the-top (OTT) application is any app or service that provides a product over the Internet and bypasses traditional distribution. Services that come over the top are most typically related to media and communication and are generally, if not always, lower in cost than the traditional method of delivery.

Reforms addressing VAT/GST collection challenges

More and more jurisdictions are introducing reforms to their VAT laws to address challenges of VAT collection and VAT fraud risks in digital sectors. As previously mentioned under section 2., the destination principle is the most followed principle where the VAT is redeemed at the consumer's jurisdiction. Also charging, collecting and remitting VAT, are traditionally the responsibility of suppliers. When the digital MNE supplier is in another jurisdiction, and when selling their products and services through intermediary marketplaces who may also be foreign entities, market jurisdictions may lack the ability to effectively enforce VAT registration and compliance (Hadzhieva, 2019).

According to Hadzhieva (2019), the United Kingdom (UK) has taken measures to combat VAT evasion that has proved useful. The UK started by a law that rendered the facilitation of domestic or foreign tax evasion a criminal offense. This meant that online marketplaces have become liable for unpaid VAT, which pushed them to monitor their sellers and ensure their compliance with the UK VAT law. In 2017, the UK authorities introduced new rules that oblige sellers to show their VAT registration numbers on the online marketplaces. This, in other words meant obliging foreign sellers to register for VAT in the UK. Hadzhieva (2019) claims that 'Requiring online marketplaces to monitor and police their sellers led to a ten-fold increase in VAT registration applications from overseas sellers in 2016'.

China on the other hand introduced a regulation with an approach different than of UK's, in April 2016, and that's to make e-commerce platforms responsible for collecting indirect taxes. However, marketplaces may not possess the technical capabilities to collect taxes like access to necessary data, which led China to consider creating a point-of-sale tax automated collecting system (Hadzhieva, 2019). Thinking alike China, Nigeria came up with a different solution when in early 2019, the Federal Inland Revenue Service announced that it would direct all banks in Nigeria to withhold 5 per cent VAT on online purchasing transactions (Rukundo, 2020).

A third option would be the 'reversed approach', or when the customer is required to declare the VAT due on a product or service received from a foreign supplier. However, this approach is found more feasible in the case of B2B and not B2C in terms of simplification requirements (Rukundo, 2020).

3. Panorama of recent unilateral direct digital tax measures and policies

With regard to unilateral direct taxation measures targeting the digital sector, the OECD (2015), had grouped the measures taken or considered by countries into 3 categories: i) a new nexus in the form of a significant economic presence; ii) a withholding tax on certain types of digital transactions and iii) an equalisation levy. A fourth category was added by OECD (2018) named "Specific regimes targeting large multinational enterprises" however, this category included measures that are not specific to the digital economy so will not be subject of this study. Table 2. Below mentions these measures and a selection of countries adopting them.

New nexus in the form of significant economic presence (SEP)

By choosing this option, a jurisdiction decides to revise Corporates' PE threshold to allow source taxation of business even in the absence of a fixed physical presence of that business. The OECD has identified 3 main approaches to determine thresholds for a SEP of a digital company in a jurisdiction, these are: i) revenue earned from the country; ii) the involvement of digital factors such as use of IP addresses and local domain names,

and iii) taking user-based factors in account, such as the number of monthly users or the amount of users data collected by the MNE, in that jurisdiction (OECD, 2018).

'The PE concept is premised on the idea that engaging in business in a state and using its economic infrastructure to gain profits gives the source state a legitimate claim to tax such profits… However, currently many digital MNEs are getting a free ride in the economy, violating the economic allegiance and benefit theories. The SEP approach is meant to address this anomaly' (Rukundo, 2020, p. 4).

The European Commission proposal issued on the 21st of March 2018, comprised a short-term action consisting of a 3% interim tax on digital services (see equalisation levy and Digital Service Tax explained below), and a long-term solution setting a SEP based on a number of factors (Hadzhieva, 2019). These are: i) digital factor: the business consists of the supply of digital services through a digital interface (whether wholly or partly). (2) The proportion of total revenues obtained from jurisdiction's users exceeds 7 million Euros (EUR). (3) The number of users exceeds 100,000. (4) The number of business contracts concluded by users located in that jurisdiction exceeds 3,000 (Rukundo, 2020).

Among developing countries, India is one example. The Indian government amended the Indian Income Tax by introducing Section 4 of the Finance Act No. 13 of 2018. It determines a SEP base using two thresholds: first, when the aggregate of payments arising from digital transactions exceeds a prescribed amount; second, based on 'systematic and continuous' soliciting or engaging in interaction with a prescribed number of users in India, through digital means. Thus, it creates a direct tax liability irrespective of the residence of the taxpayer. (Rukundo, 2020). Another example is the "Virtual Service PE", which Saudi Arabia and Kuwait can trigger for any business performing services for more than 6 months under cross-border agreements between non-resident and local consumers (Hadzhieva, 2019).

Rukundo 2020, criticised the wording of the Indian act as being vague and therefore can lead to uncertainties and to litigations by MNEs. He emphasizes that a rule based on a new nexus, liberated from physical presence should be clear, detailed, and based on simple procedures and easy to comprehend criteria. Also, he raises two difficulties with regard to SEP approach: first, its incompatibility with most Double Taxation Agreements (DTA)s as it wouldn't be valid in case of MNEs based in countries with which the market jurisdiction has a DTA (Rukundo, 2020). The second difficulty is related to MNEs having to keep separate records and accounts for their activities in other jurisdictions where they don't have PE. This can be difficult to do in some types of services. It also can be very challenging when the number of jurisdictions adopting a SEP approach or test increases with varying quantitative and qualitative criteria from a jurisdiction to another. India, for example, proposes a fractional apportioning for MNE profits generated in its market using a formula in the case of failing to provide satisfactory separate accounts and records, which also increases chances of disputes and litigations (Ibid, 2020).

Withholding tax (WHT) on certain types of digital transactions

It can be a standalone gross-base tax on certain payments to digital MNEs or, alternatively a collection mechanism to support the application of the SEP option as net-basis taxation. It consists

of expanding withholding tax on royalties[12] or taxing technical services fees as passive income. The tax has been applied in two forms: i) withholding by businesses, where WHT is constrained to B2B transactions and ii) withholding by third parties sought more often in the case of B2C transactions (Rukundo, 2020; Hadzhieva, 2019).

With regard to withholding by business, this measure allows a business making online purchases or paying royalty to its Parent company to deduct the payment when computing its income, thereby reducing its CIT liability. The withholding tax by business will limit the deduction made by subsidiaries or existing PEs. (Hadzhieva, 2019) Greece, Phillipines and Malaysia, represent example countries applying withholding tax by business (Terada-Hagiwara *et Al.*, 2019). Also, India introduced an equalisation levy (see next section, 3.3.3) that applies to digital transactions. The tax is deducted by a recipient of the service resident in India and only applies to cross-border B2B transactions (Rukundo, 2020).

Withholding by 3rd parties is often adopted to overcome the challenges of enforcing tax on a B2C transaction for the provision of technical services by foreign suppliers. For example, the city of Buenos Aires in Argentina, imposed what is now popular with the name 'Netflix tax', which consisted of a 3 per cent withholding tax. The 3rd party are the credit and debit cards processing the payments to the MNEs to act as withholding agents.

A withholding tax can be the preferred approach for developing countries who represent large consumer markets as it would allow them to increase their tax revenues and to apply their earned right to tax foreign entities without needing them to have a physical presence (UN Committee of Experts on International Cooperation in Tax Matters 2017). However, withholding tax is associated with risks of having the tax burden eventually carried by the consumer and not the business by increasing their costs for doing business. This can be particularly harmful to local start-ups as they strive getting into the market (Rukundo, 2020). Moreover, in B2C transactions, a WHT may lead to double taxation of the service provider, both at his State of residence and in the consumer's State (Hadzhieva, 2019).

Equalisation Levy (Also often called "Digital Service Tax - DST"):

Hadzhieva (2019, p. 43) explained the equalisation levy as follows: '(it) constitutes a turnover tax on e-services if it is imposed on the supply itself and where it focuses exclusively on the expenditure side of the payment (nature and value of supply),… The equalisation levy is meant to achieve tax neutrality between different businesses using distinct business models or residing within or outside the taxing jurisdiction in addition to providing greater clarity in respect of characterisation of payments for digital services. (…) The equalisation levy is revenue based and levied upon the gross value of payments exiting the source state[13]'.

India introduced an equalisation levy of 6% in 2016 on the gross value of revenues earned by digital business models, such as Google and Facebook. So far it is confined to B2B payments made to a non-resident in respect of online advertising, and the tax is withheld by the resident taxpayer as previously explained. Despite being inspired by the OECD Action 1 report of 2015 recommendations, the collection method is different. The OECD advises that the tax is

[12] A royalty is a legally-binding payment made to an individual or an entity, for the ongoing use of his or her originally-created assets, including copyrighted works, franchises, and natural resources.

[13] The Source State is the State where income is generated even if company has no physical presence, in other words the user State or market State.

collected by the supplier, while the Indian authorities decided service recipient is the one responsible to collect it. Thus, it has blurred the line between "income tax" and "turnover tax". (Hadzhieva, 2019). However, worth mentioning that it is reported that India earned around USD 47 million from this tax for the period covering June 2016 to March 2017 (9 Months) and USD 76 million for the 2017/2018 period (Terada-Hagiwara et *Al.*, 2019; Hadzhieva, 2019).

On the other hand, we find also the EU, who decided not to wait for the global solution that the OECD is seeking and announced a 3 per cent revenue-based DST, in March 2018, as an interim measure until the SEP measure is applied. The EU DST targets revenues gained through monetisation of user input and involving active and sustained user engagement. The EU enjoys taxing rights where their users are located even if the users did not generate money part of the supplier's income. So unlike India, the EU decided to follow OECD recommendation with regard to the collection of the tax by the suppliers (Hadzhieva, 2019; EU Commission 2018).

Also, France's YouTube and GAFA taxes, are some of the very known examples. France YouTube and Netflix tax, allows it to levy a 2% tax on online video advertising revenues by resident or non-resident platforms. It came into effect in the beginning of 2018. Following that, France also has introduced a tax aiming to hold giant internet MNEs to pay a fair share of taxes that reflect the huge size of business they have in France and in Europe. The tax is known as the "GAFA tax"—named after Google, Apple, Facebook and Amazon (Hadzhieva, 2019). Both French Parliamentary Houses approved the GAFA tax bill in April and May 2019. The French President signed the bill into a new law in July 2019, however, it is applied retroactively from 1 January 2019. The GAFA tax law levies a 3 per cent tax on digital services gross revenue earned in France. It targets companies with a total worldwide revenue of more than €750 million – of which at least €25 million is generated in France. The revenues attributable to France are calculated according to a formula specified in the law. (Lighthizer, 2019).

Hadzhieva (2019) highlighted a risk factor associated with the equalisation levy tax, and that it may lead to imposing a tax on loss-making businesses, due to the fact that it is levied upon the gross value of revenues or payments from the source State, thus, violate the ability to pay principle. But this is not the only criticism addressed to SDT. For example, the high revenue thresholds set by GAFA tax law in France was accused led to accusing it of discrimination, as it meant targeting only giant digital companies which exist mainly in the U.S. and China. The argument of users' value contribution especially when collecting user data for free was also criticized on the basis that data is exchanged against the service provided instead of charging the customer a subscription monetary fee. It was also found that DSTs when imposed on digital advertising services can increase production costs for domestic MSMEs when advertising is considered a key business input. The case is different for domestic MSMEs working in the same advertising industry, whereas DST allows equalising treatment between foreign suppliers and their domestic counterparts. (Rukundo, 2020).

Table 2: Unilateral direct corporate tax measures adopted by select countries in response to the rise of digitalised economy

Measure	Content	Country	Status	Features
Introducing SEP, and establishing new PE thresholds	Digital factors and/or quantitative factors i.e. number of users and revenue levels	India	To be effective from 2019	Introduction of a SEP test with two parts; if aggregate payments are carried out by a non-resident and if the business activities are systematic and continuous. The SEP applies even when there is no local agreement signed.
		European Union	Negotiations of the commission's proposals are put on hold in the EU council as international discussions in the OECD are progressing	Introduction of the concept of taxable "digital presence" based on a number of mixed criteria and thresholds.
		Saudi Arabia and Kuwait	Active from 2016	Introduced a virtual service PE. Any services by non-residents to local consumers exceeding 6 months creates a virtual PE.
Broadening the scope of withholding tax	Expanding Withholding Tax on Royalties (Withholding by Business)	Greece, Philippine, Malaysia	Active from 2016, 2003, 2017, respectively	Recognition of payments for the right to use software, visual images, or sound transmissions as royalties
	Withholding tax on technical service by third parties	City of Buenos Aires in Argentina	Introduced in 2016	Imposed what is now known with the name 'Netflix tax', which consisted of a 3 per cent withholding tax. The 3rd party are the credit and debit cards processing the payments to the MNEs to act as withholding agents.
	Equalization levy	India	Active from 2016	A 6% charge on gross consideration paid for online advertisement services supplied by non-residents. To be collected by the users.

Introducing sectoral turnover taxes		European Union	Negotiations of the commission’s proposals are put on hold in the EU council as international discussions in the OECD are progressing	An interim tax at 3 percent on certain revenue from digital activities. To be levied at the supplier.
		France	Applied beginning 2018 (Youtube tax) and beginning 2019 on retroactive basis (GAFA tax)	YouTube Tax GAFA Tax

Source: Prepared by the author based on information from Terada-Hagiwara, et *Al.* (2019); OECD, 2015a; Hadzhieva, 2019; Rukundo, 2019 and EU Commission, 2020.

SECTION 4

Conclusion

We are at the brink of transformation of the global economy as we know as digitalisation is penetrating every sector, even the most traditional ones. New Business models, totally digitalised and virtual are emerging. But the existing rules and principles founding global economy taxation and calculation of value creation, are still grounded by the "brick and mortar" company mode. Thus, governments are unable to reap the fruit of their technology leap and of their market potentials as MNEs are able to make use of the inadaptability of existing laws to their digital functioning and apply various tax schemes, allowing them to escape being fairly taxed where value and profits have been generated.

Developed countries were the ones who took the first move towards a solution, whether at the national level through unilateral measures, or by deciding to take the issue to a level of negotiations amongst them, then at the global level. But more and more Developing Countries and least developed countries are discovering the fact that they have a lot at stake as well, as they represent the emerging markets of the digital economy, where more and more people are getting access to the internet and are getting introduced to the open electronic commerce marketplaces.

Following a G20 recommendation, the OECD opened its BEPS process of negotiation for developing countries to join establishing the IF in 2016. Doing that, the OECD/G20 are now leading negotiations for new global taxation rules with a priority to reach a consensus-based solution to the challenges of the digitalised economy by end of the year 2020. While this can be a positive step towards including developing countries' interests, the BEPS framework Action Plans and the broadlines of the solutions subject to discussion had been already outlined during the period from 2013-2015 inspired by the views of developed countries. Moreover, the OECD is leaning more and more from the soft law mode it has been traditionally following to guide taxation laws in coordination and cooperation with the United Nations Committee of Experts on International Cooperation in Tax Matters, towards encouraging a hard law agreement that would prevent countries from adopting unilateral measures or national measures after a consensus-based agreement is reached.

In such a negotiating setting and with a rushing deadline to reach a consensus-based solution, developing countries and LDCs don't have the time needed to examine those solutions and understand their implications. A way around this fact is to ensure a greater role and participation of the United Nations Committee of Experts on International Cooperation in Tax Matters which has been taking the lead in advancing developing countries' interests in global tax rules. It will be very important to take all the necessary actions to ensure that developing countries are actively participating and their concerns and special needs are taken on board of the process which may determine the future of tax rules.

Although the OECD is advising against unilateral measures and has established the BEPS project and inclusive framework to avoid their growth, many developed and developing countries have decided to adopt unilateral measures. While some doubt the OECD negotiations would reach a consensus-based solution by the set deadline, others decided to explore national solutions designed to fit the country's context and needs. Unilateral measures included indirect tax imposition in the form of VAT or GST targeting the digital sector and reform of VAT collecting mechanisms. While imposing VAT on digital sector and electronic commerce sales can be a reliable source to increase tax revenues, when

applied in some African countries, they proved not so efficient especially as it led to suppressing internet usage, while those countries are in a stage where upgrading the telecommunications sector and increasing internet accessibility would allow them to gain the fruits of digital economy now and in the future.

As for direct corporate tax imposition, the measures taken by developed and developing countries revolved around three approaches. A first approach is revolutionary as it establishes new nexus based on significant economic presence, which explores ways of subjecting non-resident companies to a jurisdiction's tax authority and tax rules based on criteria that replace the PE and physical presence conditions. A second approach imposes a withholding tax on B2C and B2B transactions consisting of business royalties or sold technical services. And finally, a third approach where the user jurisdiction imposes an equalisation levy, or a tax on foreign corporates revenues with no PE. The revenue is calculated based on suppliers' payments.

The results of these measures are still early to evaluate as most of them are recent. While some proved capable of generating significant revenues, others and in specific countries' conditions, were not able to reap the same fruits. Also, while some measures are expected to generate significant revenues, they may as well lead to an indirect increase in domestic MSMEs production costs and to the suppression of the digital economy and internet access and activity expansion. In the case of developing and least developed countries, such side effects need to be avoided whatever the chosen policy approach. It is particularly recommended at this stage of the global negotiations, and with advancements on the national fronts, to learn from other countries' experiences and continue to seek guidance from the United Nations Committee of Experts on International Cooperation in Tax Matters.

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