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# Emerging Tax Issues in the Digital Economy

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# Research Questions

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- 1. What are the implications of digitalization for taxation?**
- 2. What measures do different countries have indicated they would implement?**
- 3. What is the framework for designing the tax regime as identified by different countries?**

# Outline of Presentation

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- 1. Introduction/Policy Issue**
- 2. Objective of the Study**
- 3. Overview of the Digital Economy**
- 4. Emerging Tax Issues**
- 5. Conclusion: Implications for the Philippines**

# 1. Introduction

- **Advances in information and communication technology (ICT) → digital transformations → digital economy.**

**NB. Digital economy – characterized by unparalleled reliance on intangibles, the massive use of data (notably personal data), and the widespread adoption of multi-sided business models (OECD 2018)**

# 1. Introduction (2)

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- **ICT improved business processes and promoted innovation in all sectors of the economy.**
- **New business models have emerged thus altering the global business landscape.**

# 1. Introduction (3)

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**“Trade in goods is being replaced by services, as digital information transferred over the Internet takes the place of paper books, music CDs, and other tangible goods. The Internet is displacing newspapers and magazines as the dominant advertising medium. Amid these developments, platformbased businesses, which harness digital networks to facilitate transactions between other businesses and users, are expanding rapidly in scale, scope, and influence.”**

**(Morinobu 2018, p.1)**

# 1. Introduction (4) - Policy Issue

- **Pervasive nature of digitalization → difficulty on the part of tax administrators to “ring-fence” the digital economy from the rest of the economy for tax purposes (OECD 2018; Kofler, Mayr, and Schlager 2017)**
- **The rise of digital economy poses a big challenge to governments: devise a taxation regime that generates revenue without reducing the benefits from digitalization (OECD 2018)**

## 2. Objective of the Study

- To review the literature and navigate the tax issues and challenges in the digital economy, taking note of the issues and challenges that are relevant to the Philippines

### Research Methodology:

- Desk review of various OECD, EU, and UN documents/report

“OECD, UN or EU are active in studying and looking for ways. UN (more for developing countries), OECD and EU (more for developed countries or investors). We resort to them for reference and guidance but we can have our own.” (BIR Official)

- Literature review



# 3. Overview of the digital economy

**No consensus yet on the definition of digital economy (UNCTAD 2019, APEC Secretariat 2019, UNCTAD 2017b)**

- **The entirety of sectors that operate using Internet Protocol (IP)-enabled communications and networks irrespective of industry (Lovelock 2018)**
- **All economic activities using the Internet as a platform and digital information and knowledge as key inputs for the process of producing, marketing and distributing goods and services (ILO 2018)**

### 3. Overview of the digital economy (2)

**No consensus yet on the definition of digital economy (cont.)**

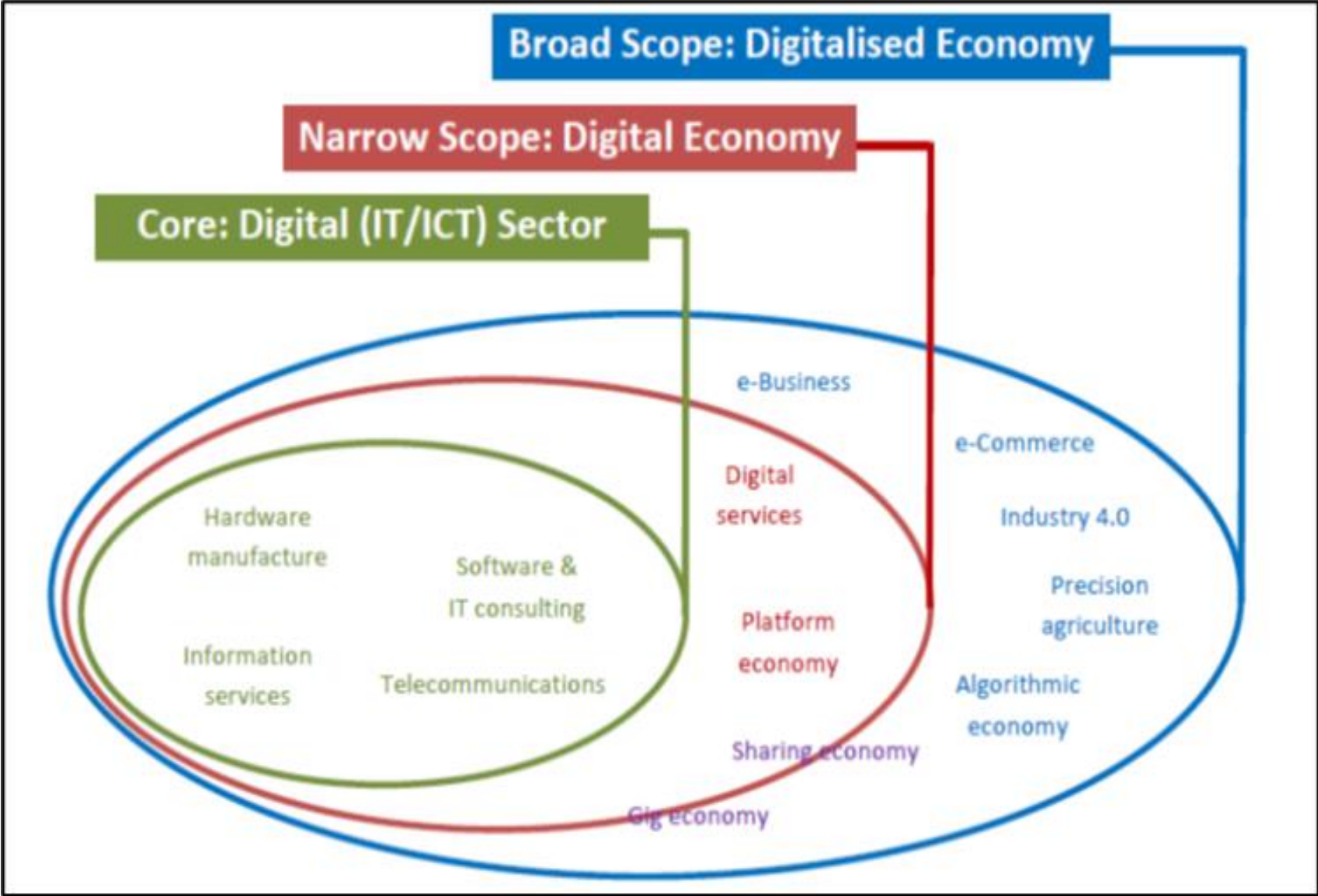
- **IMF narrow definition: online platforms, and activities that owe their existence to such platforms**
- **IMF broad definition: all activities that use digitized data, which arguably could refer to the entire economy**
- **World Bank definition: a new paradigm of accelerated economic development based on real-time data exchange; prominent role of online platforms and data in such an economy is noted**

# 3. Overview of the digital economy (3)

**Bukht and Heeks (2017) defined digital economy based on scopes of relevance:**

- 1. Digital sector – core of the digital economy referring to the IT/ICT sector producing foundational digital goods and services**
- 2. True digital economy – part of economic output derived solely from digital technologies with a business model based on digital goods or services; covers the digital sector & emerging digital and platform services**
- 3. Digitalized economy – broad scope of the digital economy referring to the use of ICT in all economic fields**

# 3. Overview of the digital economy (4)

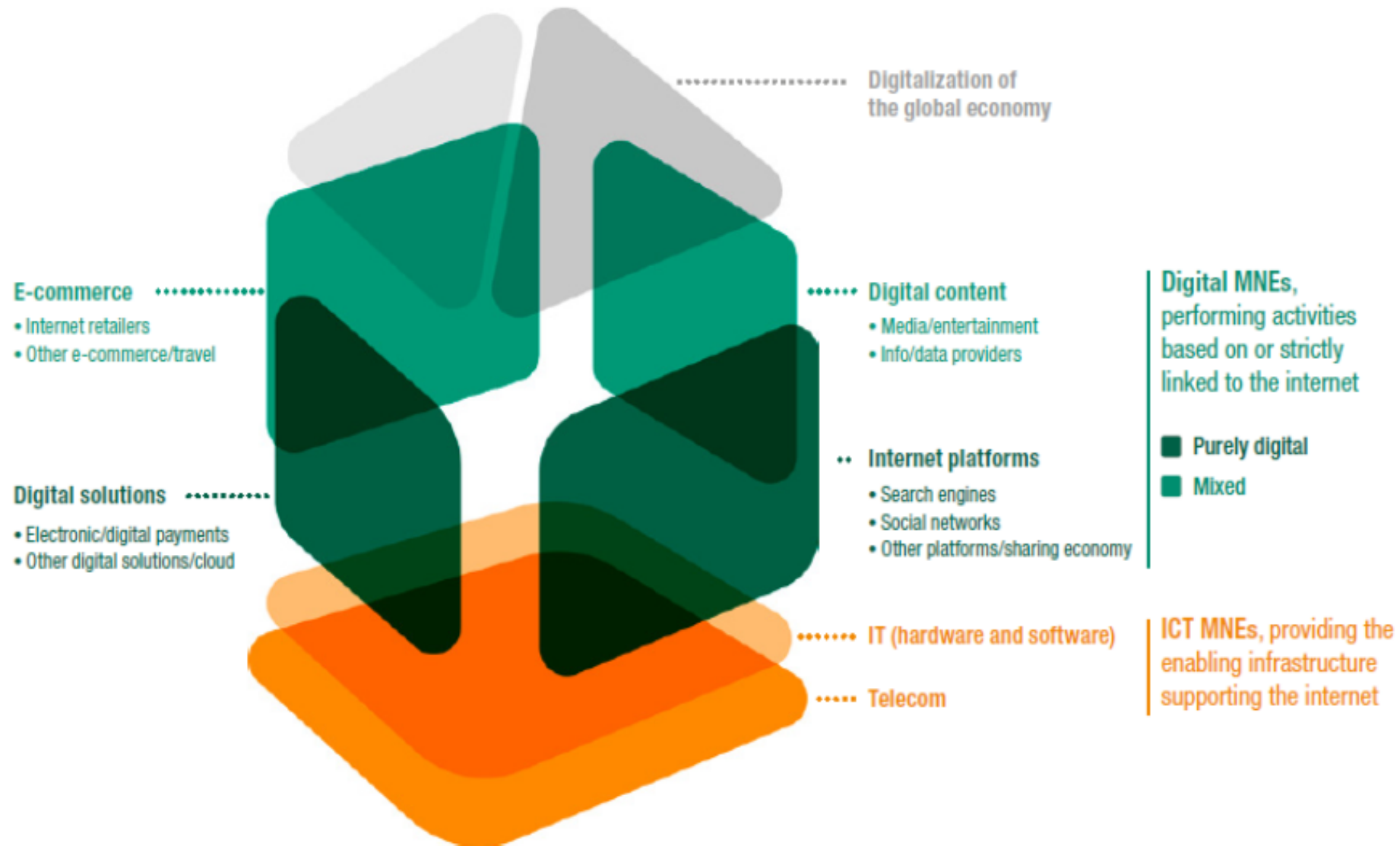


### **3. Overview of the digital economy (5)**

**UNCTAD (2017) - application of internet-based digital technologies to production and trade of goods & services; mapped digital economy into 2 types of MNEs:**

- 1. Digital MNEs – purely digital players (e.g., internet platforms and providers of digital solutions) that operate entirely in a digital environment and mixed players (e-commerce and digital content)**
- 2. ICT MNEs – provides enabling infra that makes the internet accessible to individuals and businesses (e.g., IT companies selling hardware and software, telecom firms)**

# Architecture of the digital economy



## 4. Emerging Tax Issues

**Complex & multifaceted nature of digital economy → issues and challenges in taxation in digital economy**

- **Lack of a generally agreed definition of the “digital economy” or “digital sector” and the lack of industry and product classification for Internet platforms and associated services are hurdles to measuring the digital economy.**

**Source: IMF (2018)**

## 4. Emerging Tax Issues (2)

- Improved measurement of digital products and transactions could improve measurement of inflation, BOP developments affecting external sector stability, and financial stocks and flows of relevance for countering money laundering and tax evasion.

Source: IMF (2018)

**NB. Reaching a common definition and measurement of the size of the economy is critical in devising a tax regime for the digital economy.**



# 4. Emerging Tax Issues (3)

**Disruptions in traditional sectors – due to new business models created by digital technologies and tools**

- 1. First model (i.e., based on substitution of existing products or services, enabled by digitalization) or product or service substitution**
  - a. music cassettes and compact disks being displaced by streamed music online (e.g., Line Music and Spotify)**
  - b. movies that were previously stored in physical media such as CDs and DVDs are now digitally delivered (e.g., Netflix)**
  - c. printed motorway maps being displaced by GPS systems in smartphones (e.g., Google Maps and Waze) that are currently widely used in navigation**
  - d. books and magazines that used to be available in physical form being displaced by e-books/e-magazines (i.e., saving costs related to printing and storage)**

# 4. Emerging Tax Issues (4)

2. **Second model (i.e., involving digital services that by-pass traditional channels and reduce costs for end-users) or by-pass**
  - a. **payment no longer goes through existing gatekeeper, thus eliminating demand for its services (e.g., fund transfers through financial technology or fintech, for short like P2P funds transfer offered by TransferWise, i.e., by-passing banks or online insurance sales platforms, i.e., eliminating the need for an agent network)**
  - b. **firms that provide crowd-funding services and offer borrowers an alternative to bank financing such as Kickstarter and RocketHub**
  - c. **online purchase of insurance (e.g., FWD and DirectAsia)**
  - d. **online purchase of airline tickets/customized tickets (e.g., Expedia or Traveloka)**

## 4. Emerging Tax Issues (5)

3. **New digitally-enabled business model or technological paradigm shift (e.g., cloud computing, i.e., a fundamental change in how consumers procure, access & use IT infra while offering lower costs and rapid scalability)**
  - a. **businesses subscribe to cloud services (e.g., Alibaba Cloud, Google Cloud, Amazon Web Services, and Microsoft Azure) instead of procuring and maintaining their own servers, thus providing firms flexibility of adjusting their subscription based on needs and also, the benefit from some features (e.g., protection against hackers and cyberattacks, and enterprise solutions such as database management, data analytics, web hosting, and various human resources applications)**

# 4. Emerging Tax Issues (6)

## Major policy challenges w.r.t. direct taxation

- a. **Nexus - continual increase in potential of digital tech and reduced need in many cases for extensive physical presence in order to carry on business, combined with increasing role of network effects generated by customer interactions, can raise questions as to whether the current rules to determine nexus with a jurisdiction for tax purposes are appropriate**

## 4. Emerging Tax Issues (7)

**Major policy challenges w.r.t. direct taxation (cont.)**

- b. Data – growth in sophistication of info tech has permitted companies in digital economy to gather and use info across borders to an unprecedented degree; raises issues of how to attribute value created from generation of data through digital products and services, and of how to characterize for tax purposes a person or entity's supply of data in a transaction (e.g., as a free supply of a good, as a barter transaction, or some other way)**

## 4. Emerging Tax Issues (8)

Major policy challenges w.r.t. direct taxation (cont.)

- c. Characterization - development of digital products or means of delivering services creates uncertainties in relation to the proper characterization of payments made in the context of new business models, particularly in relation to cloud computing**

## 4. Emerging Tax Issues (9a)

Policy challenges raise questions relating to:

1. Whether the current international tax framework is still appropriate or relevant in dealing with changes that digital economy brings and business models it creates;
2. Allocation of taxing rights between source and residence jurisdictions
3. Paradigm used in determining where economic activities are carried out and value is created for tax purposes<sup>23</sup>

## 4. Emerging Tax Issues (9b)

Policy challenges raise questions relating to (cont.):

4. Double non-taxation that may arise from lack of nexus in market country under current rules and also, lack of taxation in the jurisdiction of the income recipient and of the ultimate parent company
5. Issues relating to base erosion and profit shifting (BEPS)



## 4. Emerging Tax Issues (10a)

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**Challenges w.r.t corporate income tax:**

- 1. Characterization of payments may trigger taxation in the jurisdiction where the payor is resident or established and hence overlap with the issue of nexus.**

## 4. Emerging Tax Issues (10b)

**Challenges w.r.t corporate income tax (cont.):**

- 2. Collection of data from users located in a jurisdiction may trigger questions regarding whether it should give rise to nexus with that jurisdiction, and if so, whether and how the income generated from the use of these data should be attributed to that nexus; also raises questions regarding how income from transactions involving data should be characterized for tax purposes**

## 4. Emerging Tax Issues (11a)

**Challenges w.r.t VAT systems – arise when goods, services, and tangibles are purchased from suppliers abroad in the absence of an effective international framework to ensure VAT collection in the jurisdictions of consumption**

- 1. For economic actors (e.g., SMEs) – absence of an international standard for charging, collecting, and remitting tax to a potentially large number of tax authorities creates difficulties and high compliance costs**

# 4. Emerging Tax Issues (11b)

## Challenges w.r.t VAT systems (cont.)

2. From gov't viewpoint – there is a risk of loss of revenue and trade distortion, as well as the challenge of managing tax liabilities generated by a high volume of low value transactions, which can create a significant administrative burden but marginal revenues

# 4. Emerging Tax Issues (12)

Simply put by Evans et al. (2021)

1. How to tax a multinational business (and other businesses) on sales into a territory where it has little or no physical presence?
2. How to assign a value to user-generated data and content and then tax that value?
3. How to compensate for the possible reduction in labor tax revenues due to the automation of routine tasks?

## 4. Emerging Tax Issues (13)

- **Huge challenge: Taxation of the intangibles (i.e., digital and cross-border flow of goods and services)**

**NB.1. The current international tax framework was originally designed for “brick and mortar” economy.**

**NB.2. Brick and mortar businesses – companies with physical presence or permanent establishment that is used to assign tax jurisdiction**

**NB.3. New business models do not require physical presence; easily cut across borders**

**NB.4. Rise in digital economy unveiled opportunities for tax avoidance**

## 4. Emerging Tax Issues (14)

- **Heavy reliance on digital technology, borderless economy, and outdated tax rules enables business models to:**
  - **escape taxation in jurisdictions where they do business (i.e., countries of consumption/where users are located)**
  - **shift profits to low-tax countries (otherwise known as tax haven)**

Source: Moribonu (2018)

- **Taxation of digital transactions in cross-border context presents challenges to concepts of right to tax and allocation of profits between countries (AICPA 2018).**

## 4. Emerging Tax Issues (15a)

- Weaknesses in current rules create opportunities for base erosion and profit shifting/BEPS (OECD 2015).

**BEPS – tax planning strategies used by MNEs that exploit gaps and mismatches in tax rules to avoid paying tax.**

**International organizations (e.g., OECD, EU, & UN) have endeavored to define challenges and come up with an international consensus on the best strategy.**

**Source: OECD (2014)**



## 4. Emerging Tax Issues (15b)

**NB.1. Addressing BEPS is a key priority. In 2013, OECD and G20 countries adopted a 15-point Action Plan (AP) to address BEPS.**

**AP → ensure that profits are taxed where economic activities generating the profits are performed and where value is created**

**Source: OECD (2014)**

## 4. Emerging Tax Issues (16a)

**NB.2. 2015 - OECD released 2015 Final Report that contains the BEPS issues and broader tax challenges BEPS raises as well as some recommendations.**

**NB.3. 2018 – OECD released an interim report that provides an in-depth analysis of the main features of highly digitalized business models and value creation, as well as potential implications for the existing international tax framework.**

## 4. Emerging Tax Issues (16b)

**NB.4. 2020 – OECD/G20 Inclusive Framework (IF) on BEPS issued statement on the two-pillar approach to address the tax challenges arising from the digitalization of the economy**

**On Pillar One - IF endorses the Unified Approach that aims to address the issue on nexus and profit allocation**

**On Pillar Two – Work in progress; meant to ensure minimum level of taxation**

## 4. Emerging Tax Issues (17)

**NB.5. To date, there is no consensus yet on the best strategy to address tax issues/challenges. “Members of IF on BEPS affirm their commitment to reach an agreement on a consensus-based solution by the end of 2020 (OECD 2020, p.4).”**

**NB.6. IF agreed upon an outline of the architecture of a Unified Approach on Pillar One as basis for negotiations and welcomed progress made on Pillar Two.**

**Nevertheless, efforts by international bodies do not preclude individual countries from unilaterally proposing their own solutions.**

# 4. Tax/Rules Proposed/Enacted

## Philippines

### - BIR Revenue Memo Circular 55-2013 (Section II)

**“Existing tax laws and revenue issuances on the tax treatment of purchases (local or imported) and sale (local or international) of goods (tangible or intangible) or services shall be equally applied with no distinction on whether or not the marketing channel is the internet/digital media or the typical and customary physical medium.”**

**NB. Taxation rules and guidelines on non-online transactions are applicable to online transactions (e.g., B2C, C2C, & B2B).**

# 4. Tax/Rules Proposed/Enacted (2)

## Philippines

### - BIR Revenue Memo Circular 60-2020

Notice for all persons engaged in business and earning income, particularly those who are into digital transactions to register their businesses; covers all partner sellers/merchants as well as other stakeholders (e.g., payment gateways, delivery channels, internet service providers, and other facilitators)

# 4. Tax/Rules Proposed/Enacted (3)

## Philippines

- **Proposed HB6122 (by Cong. Wes Gatchalian)**

**An Act Protecting Consumers and Merchants Engaged in Internet Transactions, Creating for this Purpose the Ecommerce Bureau and Appropriating Funds Therefor**

**NB. Proposes creation of the Ecommerce Bureau; registration of online businesses/enterprises and exemption from business tax in the first two years of operation**

# 4. Tax/Rules Proposed/Enacted (4)

## Philippines (cont.)

- **Proposed HB6765 (by Cong. Joey Salceda)**

**An Act Establishing a Fiscal Regime for the Digital Economy, Amending for the Purpose Sections 57, 105, 108, and 114 of the National Internal Revenue Code, and for Other Purposes**

**NB. Proposal will effect changes to the way the digital economy is currently taxed, to better capture value created into the tax system**



# 5. Conclusion

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- 1. The issues and challenges in taxation in digital economy stem from its complex and multifaceted nature.**
- 2. Reaching a common understanding and measurement of size & impact of digital economy is critical in devising a tax regime for digital economy.**
- 3. Philippines identified scoping and measurement of digital economy as one of the barriers & challenges (i.e., along w/ regulatory & legal framework incl. sandboxes & digital infra gap) to implementing structural reforms relating to digital economy. (APEC Secretariat 2019)**

## 5. Conclusion (2)

**NB. Lack of official industry data that will measure contribution of digital trade to economy's overall economic growth - no single standard definition of digital trade and technical innovations and new business models do not exactly fit with traditional sectoral classifications (e.g. Grab); PSA has started efforts in Aug 2018 to measure contribution of digital economy to GDP**

**Ilarina, Polistico, and Pascasio (2019): satellite accts are not yet formulated and still, there is lack of statistics that explicitly measure digital economy; pointed out the lack of int'l definition and statistical framework as well as int'l guidelines with respect to measurement of digital economy**

## 5. Conclusion (3a)

**On digital infra gap - problems concerning**

- **internet availability (e.g., 74% of secondary schools lack internet access)**
- **affordability (e.g., prices of ICT services are among the highest in ASEAN)**
- **reliability/quality of digital infra (i.e., slow inet speed, lowest among economies in Asia Pacific)**

# 5. Conclusion (3b)

**NB.1. UNCTAD (2019): Digital infra – still lacks a universally accepted definition; levels of digital infra:**

- i. ICT networks (i.e., the core digital infrastructure for connectivity)**
- ii. data infra (i.e., data centres, submarine cables & cloud infra)**
- iii. digital platforms (i.e., not strictly infra but can also be agents participating in activity that takes place on them, or performing infra-like functions by connecting 2 or more sides of a market)**
- iv. digital devices and applications**

**NB.2. Electricity infra is critical in enabling the use of digital infra.**

## 5. Conclusion (4a)

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4. The opportunities and challenges that digital economy brings are particularly important for developing countries, including the Philippines.

**NB. It is deemed critical for the Philippine gov't to:**

- a. eliminate the barriers and challenges
  - b. address the identified policy gaps
- to fully reap the benefits from the digital economy

## **5. Conclusion (4b)**

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**The need for development strategies for the digital economy cannot be overemphasized.**

**Focus of development strategies: developing domestic digital capacities (i.e., closing the gap in digital infra, which necessitates estimation of investment requirements)**



**Thank you!**