



G24 TGM

Taxation Challenges: A Focus on the Digital Economy

March 15, 2019

Lima



Outline for the session

- ▶ What are the challenges arising from the taxation of the digitalized economy, from the perspective of developing countries?
- ▶ What is the role of international tax cooperation, and what role can the G-24 play?
- ▶ How are developing countries coping with new taxation challenges and, in this regard, how can international organizations better support developing countries?



Digital Economy/Sector



- ▶ Digitalization encompasses a wide range of new applications of information technology in business models and products that are transforming the economy and social interactions. Digitalization is both an enabler and a disruptor of businesses.
- ▶ The 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.
- ▶ Difference between the “digital sector” and the increasingly digitalized modern economy, often called the “digital economy,” and focuses on the measurement of the digital sector. **The digital sector covers the core activities of digitalization, ICT goods and services, online platforms, and platform-enabled activities such as the sharing economy.**



Digital economy/Sector

- ▶ Available evidence suggests that the digital sector is still less than 10 percent of most economies if measured by valued added, income or employment.
- ▶ However, it is more realistic to focus measurement efforts on a concrete range of economic activities at the core of digitalization. **While the term “digital sector” refers to a concrete perimeter of economic activities, the term “digital economy” is often used to indicate that digitalization (e.g., the use of Internet) has spread across all sectors of the economy, from agriculture to warehousing.**

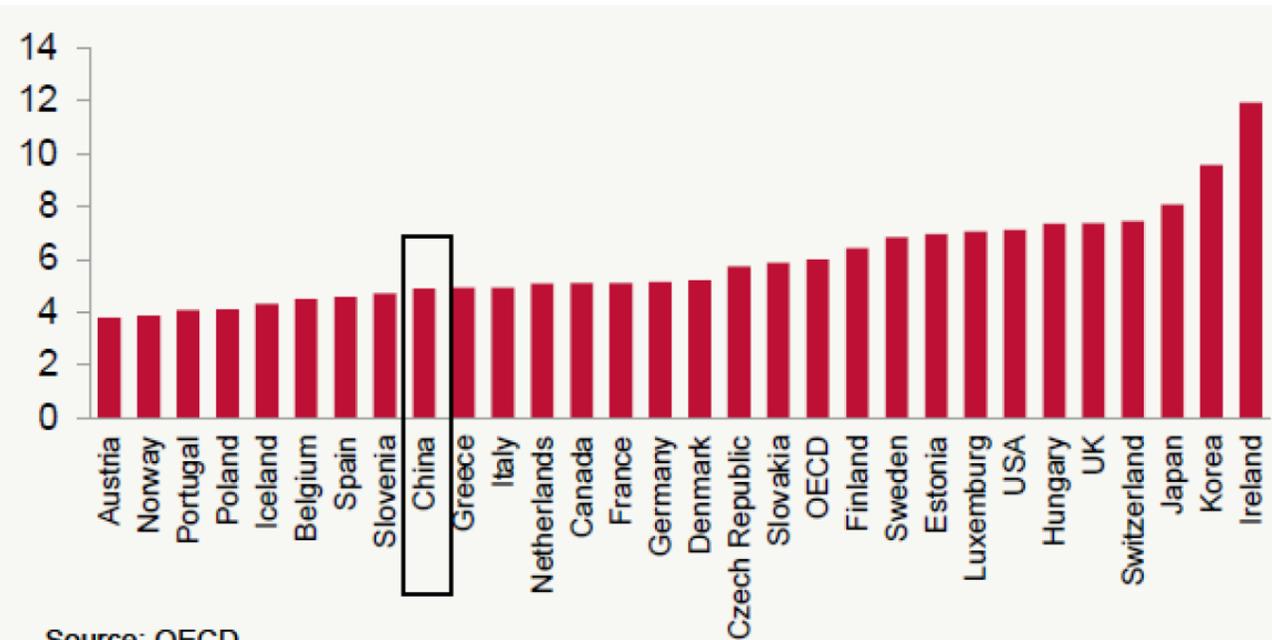


Value of digital economy

- ▶ In 2016, the global digital economy was worth \$11.5trillion, or 15.5 percent of global GDP,
- ▶ and it is expected to reach 25 percent in less than a decade
- ▶ 4 billion people still unconnected.
- ▶ China's digital economy amounted to 30 percent of GDP in 2016 (Tencent, 2017). However, when measured by value added of industries in the ICT sector, China's digital sector was 5 percent of GDP in 2012 (Figure 1)

ICT sector share of GDP Based on value added

Figure 1. ICT Sector Shares of GDP based on Value Added, 2012



Source: OECD

Source: Garcia Herrero and Xu (2017).

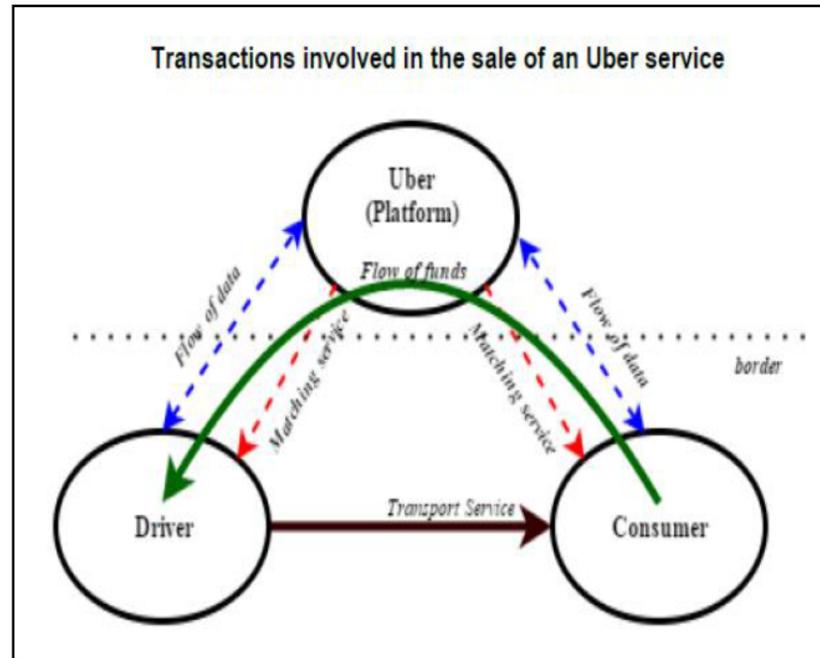


Globalization/Digitalization

- ▶ Digitalization has made it easy to fragment global production processes, and to separate the locations of production and consumption of services. **Furthermore, intellectual property assets, which play a large role in many digital enterprises, are easily redomiciled.**
- ▶ Consequently, the global production of a multinational enterprise (MNE) may be spread across different countries in a way that makes the production location an ambiguous concept.
- ▶ **Relocations by MNEs for tax reasons may generate concerns about whether the reported location of production best describes where the production really took place, and about the meaning of BOP and international investment position (IIP) statistics.**
- ▶ These relocations may be accomplished by moving the MNE headquarters (often via a corporate inversion), by implementing a holding company structure, or by selling intellectual property and other moveable assets to an overseas affiliate.
- ▶ Relocations of MNEs are not limited to digital enterprises, but they affect the measurement of the digital sector because many digital enterprises have headquarters or intellectual property assets in a tax-advantaged jurisdiction.

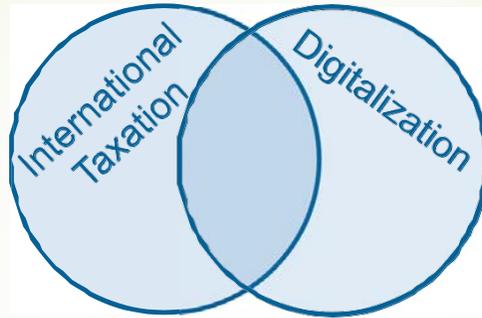
Shared Economy

Figure 4. International Flows of Data and Services in a Platform-Enabled Transaction



Source: Fortanier and Lopez Gonzalez (2017).

Intersection



- Digitalization raises several international tax issues
 - How to tax profits in an increasingly digital economy?
 - How to tax digital sales under VAT?

The former is especially contentious and immediate

→ Exemplifies deeper debate on international tax principles

The trillion dollar club

Global Top 20 Firms by Stock Market Capitalization
(US\$ billions; Feb 14, 2018)



Sources: Thomson Reuters Datastream and IMF staff calculations.

Notes: ICBC=Industrial and Commercial Bank of China; CCB=China Construction Bank.

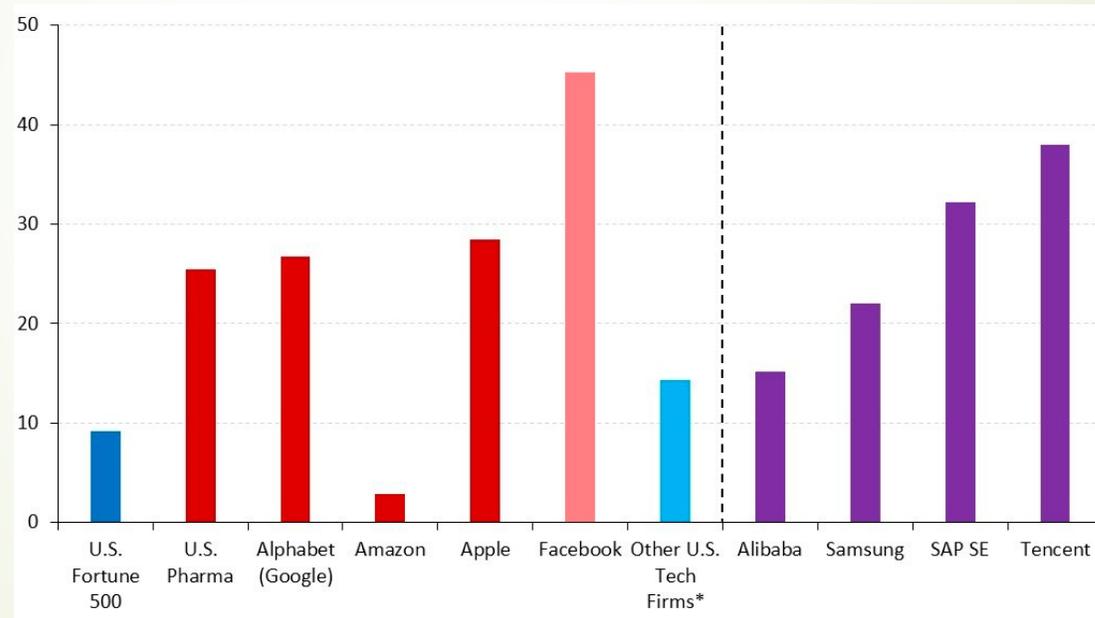
Red bars highlight tech-related companies.

Large profits

First-mover advantage + network effects => natural monopolies

- Primarily an issue for competition policy
- More general tax principle: how to effectively tax economic rents?

Profit margins of several digital companies higher than average
(Profits as a share of turnover, 2016; in percent)



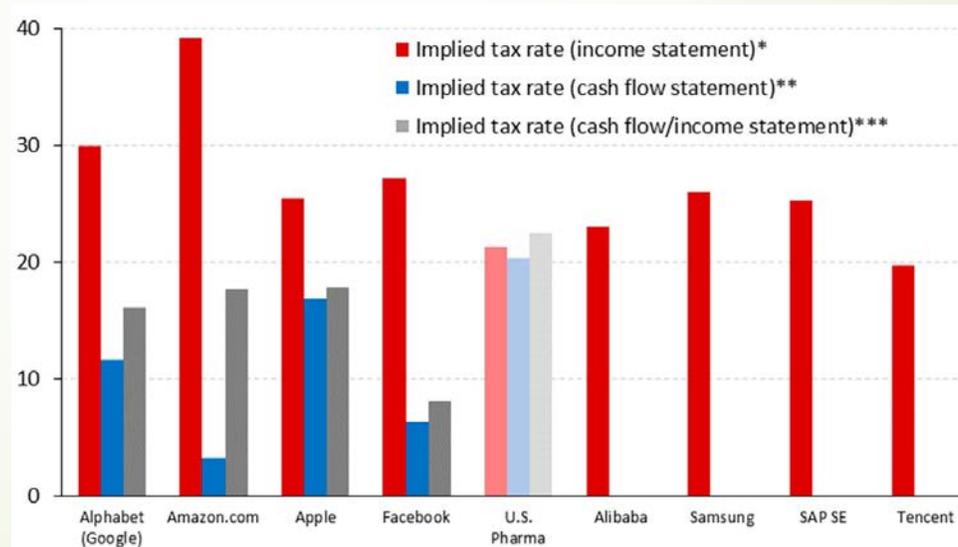
Sources: Fortune 500, Bureau van Dijk Orbis, and IMF staff calculations.

Notes: * Calculated as the median of excess of income over 10 percent of value of tangible assets; ** Average Fortune 500 firms matched to ORBIS data; ** Includes companies from multiple NACE sectors, including 2620 (manufacture of computers and peripheral equipment), 5829 (other software publishing), 6201 (computer programming activities), and 6209 (other information technology and computer service activities).

Low taxation?

- Limitations on available data (chart)
- Total tax liability versus distribution across countries
- U.S. corporate tax reform a major change

***Implied tax burden
based on consolidated
income and cash flow
statements***
(In percent; average of
2015-17)



Sources: Company-specific 10K SEC filings and IMF staff calculations.

Notes: * Average over 3 years (2015-17) of ratio of "provision for income taxes" to "income before income taxes". ** Average over 3 years (2015-17) of share of "cash paid for incomes taxes" to "cash generated from operating activities". ***Average over 3 years (2015-17) of share of "cash paid for incomes taxes" to "income before income taxes".

THE issues

- (1) Large profits from digitalization,
- (2) Intensive use of intangible assets, ...
- (3) Sales without physical presence ...
- (4) User-generated value ...
... is relatively newer issue; but disagreement over whether/how this challenges current international tax design



G24 position

- ▶ G24 Working group –Interim Report in BALI and report to OECD on Digital taxation.
- ▶ Under Chair of Sri Lanka and continuing under Chair of Peru
- ▶ 12 countries member of the Group(Algeria, Colombia, Cote d'Ivoire, DR of Congo, Ecuador, Gabon, Ghana, India, Nigeria, Peru, South Africa and Venezuela).
- ▶ Digitalization taxation group-Columbia and India
- ▶ Great work by G24 Sectt.



Thank you.