

# Taxing the digitalized economy

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## Three groups of countries

1. Only targeted changes needed: ring-fence digital HDBs
2. Changes to affect entire tax system, not only HDBs
3. Do not currently see the need for any significant reform

(OECD Interim Report 2018)

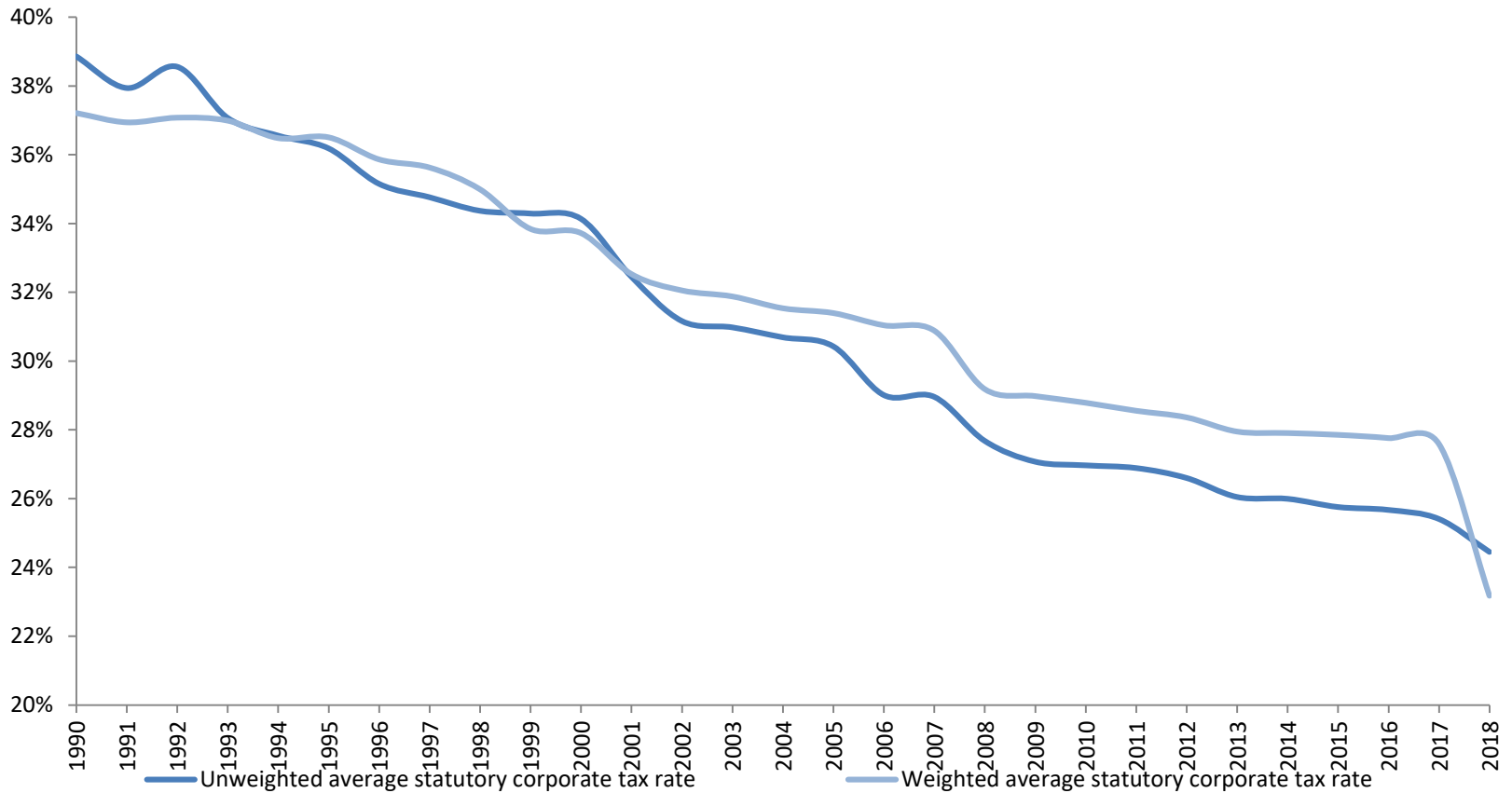
“A second group of countries take the view that **the ongoing digital transformation of the economy, and more generally trends associated with globalisation, present challenges to the continued effectiveness of the existing international tax framework for business profits.** Importantly, for this group of countries, these challenges are not exclusive or specific to highly digitalised business models.”

(OECD Interim Report 2018)

# What comprehensive reform should we have?

- Start by identifying root cause of problem...
- Digitalization exacerbates existing problems - internationalization
- Problems partly stem from taxing in location of mobile factors
- Include:
  - Profit shifting
  - Distortion of real economic activity
  - Instability due to tax competition

# G20 Average Corporate Tax Rate



## What comprehensive reform should we have?

- Problems not new but digitalization exacerbates them
- If mobility source of problems – address that directly
- Tax where *immobile* factors located, e.g. consumers (destination)
- Should help on all 3 problems, depending on how it is done
- Have issues too, but greater promise for the long term
- Should not be as controversial anymore
- Destination elements in proposed reform
- Comprehensive and coherent move to destination preferable

# What comprehensive reform should we have?

- Different options:
  - Destination Based Cash Flow Tax (DBCFT)
  - Sales-based Formulary Apportionment
  - Residual Profit Allocation
    - Avi Yonah, Clausing and Durst (2009)
    - Schreiber and Fell (2017)
    - Devereux et al (forthcoming)
- Winners and losers
  - But we should focus on long term

# Commission's Long Term Solution

## Digital PE and Profit Attribution

### ***1. Guiding principle: profit taxed where value created***

- Difficult even conceptually
  - “In a digitalised world, it is not always very clear what that value is, how to measure it, or where it is created.” EU Communication
  - Does it make sense to build tax system on such a principle?

### ***2. Further complexity***

- System more complex and impenetrable
- Can most (all) countries operate such rules?



## Commission's Long Term Solution

### **3. Ring-fence**

- Commission's High Level Expert Group on Taxation of the Digital Economy (2014)  
*"there should not be a special tax regime for digital companies."*
- Conceptual and practical reasons
- Future-proof?
  - Commission's objectives include: "ensuring the corporation tax system is future-proofed and sustainable in the long-term."

### **4. New element**

- Destination element overlaid over existing system
- Not applied comprehensively and coherently

### **5. Does not address broader problems with the existing system**

“Fundamental reforms, such as destination-based cash flow tax, unitary taxation and residence tax base with destination tax rates, would **not only fundamentally challenge the international tax system, but they also have the potential to address the problems at their roots. They however do not yet seem to be a priority of Member States at this stage, who prefer to adapt the current system**”.

(EU Impact Assessment 2018)