Asia and the Pacific: Shaping future tax policies in a digital era

Technological advancements bring both opportunities and challenges for taxation policy. Although they improve revenue raising and efficiency of spending, to fully harness such benefits requires concerted national and international efforts. Asian and Pacific economies are at the forefront in reforming taxation policies in a digital era to counter under- or double-taxation.

New information and communication technologies trigger a structural transformation of the world economy. Digitalization generates innovative products, new business models and employment opportunities. A variety of web-based services, such as eCommerce and social media platforms continue to gain economic importance. By 2025, the digital economy in the ASEAN region alone is expected to triple in size (Google & Temasek, 2018). The impact of digitalization, however, is not bound to one economic sector alone, but affects the economy as a whole. 3D printing, automation, and remote working opportunities reshape production and organization within corporations. Those profound changes of the economy pose opportunities and challenges for fiscal and tax policy makers.

A boon for fiscal policies

In the arena of fiscal policy, technological progress opens opportunities to improve fiscal space and to strengthen tax administration. From the revenue side, digitalization helps expand fiscal space by broadening tax base and improving taxpayers’ compliance. Technological progress has given birth to new economic activities, such as eCommerce, shared economy and social media, which if taxed, can broaden the tax base and thereby increase overall tax revenue. In addition, technologies such as e-filing, e-payments and e-customs initiatives facilitate tax authorities to collect information, improve resource management and lower taxpayers’ compliance costs (Bird, 2010). Some countries have started to benefit. For example, in Malaysia, e-filing and e-payments have improved compliance ratio by nearly 30 percent and increased tax revenue by 1 percent of GDP during 2006 and 2011 (World Bank, 2013). Russian Federation’s e-value added tax (VAT) system increased VAT revenue by more than 12 percent in 2015 (Dobell, 2017).

From the expenditure side, technology advancement improves efficiency of public spending through more efficient distribution. For example, India’s Aadhaar, the world’s largest biometric identification system, links various subsidies with bank accounts directly, preventing claims from ghost beneficiaries or multiple claims (Gaspar and Rhee, 2018). In Philippines and Indonesia, digital social registry systems were established to allow direct cash transfer to household in need, which largely improves transparency and credibility of social protection programmes (Philippines’ Department of Social Welfare and Development, 2018; Indonesia’s Office of the Vice President, 2015).

Challenges to fully harness the benefits of digitalization for raising revenues

Despite the potential to improve fiscal space and tax administration, how to fully harness such benefits remains a question. Conceptually, current tax laws rest upon the basic principle that commercial activity should be taxed in the location where it takes place. Yet, new technologies enable companies to be active in one jurisdiction without maintaining a physical presence, such as through online platforms. As a consequence, if tax law does not account for this business model, it leaves growing shares of the economy under taxed.

Intangible assets traded on online platforms complicates taxation in digital economy further. Business models in the digital economy relates to various forms of intangible assets. For example, streaming platforms profit from managing intellectual property rights on music and movies; and social media platforms and search engines monetize their user data by selling it to third parties for targeted advertising. Taxing businesses trading intangible assets raises questions such as: Which tax jurisdiction has the right to tax the profits from intangible assets, if a multinational enterprise (MNE) manages those assets across country borders? How can the added value of data analysis be taxed most effectively, fair, and without reinventing innovation?

These questions are also closely linked with the concept of permanent establishment of a company, i.e. in what jurisdiction a company is subject to corporate income tax. International tax conventions suggest the so-called nexus approach to link intangibles to a location they are used at for value creation. In practice, the nexus approach lacks clarity and still allows for aggressive tax planning by MNEs. In detail, MNEs often register their intangible assets in low-tax jurisdictions, the companies of their tax planning. Then, even though the services are delivered in high-tax jurisdictions, the companies can artificially shift their profits from high-tax to low-tax jurisdictions. Such aggressive tax planning is not illegal, but could result in tax base erosion, and MNEs being effectively undertaxed.

Adapting tax regimes to the digital economy

For technology-induced tax revenue benefits and countering undertaxation in the digital economy, concerted national and international efforts are...
needed. At the national level, reforming the VAT and goods and services tax (GST) regimes is essential to better capture value creation in the digital economy. This is particularly relevant for the Asia-Pacific region, as developing countries in the region heavily rely on taxes on goods and services, which accounts for over 30 per cent of their total revenues, higher than the OECD average.

To levy VAT and GST from cross-border e-commerce, multiple agents may collaborate closely: tax administrations need to adapt their procedures to collect VAT based on digital invoicing and not paper trails alone; they could partner with customs to collect VAT on imports from online market places; and web-based platforms should assist tax administrations by offering sellers simple online solutions to register for taxation.

Many countries are progressing towards imposing special taxes on digital services. For example, India imposed a turnover tax on digital advertisement services from non-resident companies. Australia introduced a diverted profit tax targeting MNEs in particular – if an MNE is proved to have artificially diverted its profits, it will be taxed at the rate of 40 per cent. In addition, China, Japan, New Zealand, the Philippines, Republic of Korea, Russian Federation, and Turkey have implemented adaptations to VAT or GST tax collections from e-commerce. Further reforms are currently underway in Indonesia, Malaysia, Thailand, and Singapore, among others (OECD, 2018b). However, auditing MNEs for profit diversion could impose an additional resource burden on tax authorities.

While those national measures successfully prevent double non-taxation of digital services, they also create new challenges: since some countries levy consumption taxes and other turnover taxes, digital services are possibly being taxed twice. Such double taxation is a distortion to investment and growth. Meanwhile, the increasing complexity of international taxation induced by unilateral initiatives impedes tax compliance by the corporations and enforcement effectiveness by tax administrations.

Therefore, international cooperation to harmonize national tax policies in the context of a growing digital economy is critical. More than 120 countries worldwide are currently involved in international tax cooperation efforts under the OECD Base Erosion and Profit Shifting (BEPS) Project in order to better align taxation with economic activity. In Asia and the Pacific, 25 economies (as of January 2018) had joined the Inclusive Framework of the BEPS Project. Back in 1998, the WTO adopted the Declaration on Global Electronic Commerce, which brings its members to discuss e-commerce taxation issues nowadays. In early 2019, over 70 WTO members agreed to commence WTO negotiations on trade-related aspects of e-commerce, including 16 economies from the region.

Despite global efforts to harmonize national tax laws and bilateral and multilateral tax treaties, it is difficult to find a single set of international tax rules to solve increasingly complex tax issues. A multilateral consensus on taxing the digital economy must allow flexibility by taking into account country-specific characteristics so that each country can also pursue its individual priorities according to its capacities and interests.

Digitalization helps improve efficiency of spending and strengthen tax administration. Many Asia-Pacific economies are reforming taxation policies according to new business models in a digital era. With international conventions and model treaties issued by such as the OECD providing some degree of international standardization of bilateral or multilateral tax arrangements that ultimately regulate the taxation of cross-border transactions, continuous efforts are needed to adapt multilateral taxation to new innovation in a digital economy.

Endnotes

1 Data retrieved from OECD (2018a).
2 The 16 economies are: Australia, Brunei Darussalam, China, Hong Kong, Japan, Kazakhstan, Republic of Korea, Lao PDR, Malaysia, Mongolia, Myanmar, New Zealand, Russian Federation, Singapore, Thailand, and Turkey. Despite of 16 economies’ support, India decided not to join the initiative as the country believed that it was not the right timing to take on multilateral obligations in the area of e-commerce rules.

References


