Taxing the Digital Economy: CIT and VAT

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EESC - ECO Meeting
I. General Considerations on Taxing the Digital Economy
   I. What is the digital economy?
   II. Traditional vs modern tax systems
   III. Reactions to challenges

II. Substantive Tax Rules
   I. CIT vs VAT
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   III. VAT: new paradigm

III. Tax Enforcement
   I. New enforcement methods
   II. Understanding Fraud Phenomenon
   III. Crime Management in Taxation

IV. Are Tax Rules Prepared for the Digital Economy?
GENERAL CONSIDERATIONS ON TAXING THE DIGITAL ECONOMY

Digital Economy

- Digital supplies / online shopping
- Sharing economy
- New economic structures
- Dominance of intangibles
GENERAL CONSIDERATIONS ON TAXING THE DIGITAL ECONOMY

Power to Tax

Substantive Jurisdiction

Legitimacy to tax, i.e. a connection between what is being taxed and the country imposing the tax that is sufficiently strong to legitimise that tax

Enforcement Jurisdiction

Ability to tax, i.e. whether the country has effective legal and implementing means of collecting the proposed tax
GENERAL CONSIDERATIONS ON TAXING THE DIGITAL ECONOMY

Traditional tax systems
- Territorial and physical
- Clarity on substantive and enforcement jurisdiction to tax: residence country and source country

Modern tax systems?
- Globalised and digital
- Unclear substantive and enforcement jurisdiction to tax: mobility of both residence and source
GENERAL CONSIDERATIONS ON TAXING THE DIGITAL ECONOMY

Reaction to Challenges

CIT

Protection of Status Quo
Position of OECD and G20 members

External Pressures
Budget deficit and austerity measures
Media attention and public anger against MNE

VAT

Protecting Revenues
Revenue capacity and business cycles imperviousness
NGOs and tax lobbying groups

Internal Pressures
Old and unsuitable rules
World spread of VAT
SUBSTANTIVE TAX RULES: CIT VS VAT

G20 / OECD / EU Reform Proposals

CIT
- Conservative approach
- Maintaining taxation at country of source and residence, with anti-avoidance rules

VAT
- Bold approach
- Moving to full taxation at country of destination
SUBSTANTIVE TAX RULES: CIT

ANTI-AVOIDANCE RULES

Addresses symptoms, not causes of tax avoidance

Always one step behind

If incentives are not removed, symptoms will reappear
CRITERIA TO MAXIMISE TOTAL WELFARE

MINIMUM DISTORTION TO ECONOMIC BEHAVIOUR

- to identify a location of taxation which creates minimum distortion to the economic behaviour of multinational companies, to the ownership of assets and to competition between companies selling in the same market; and

JURISDICTION TO TAX

- to identify a location of taxation that has jurisdiction to tax, from both a substantive perspective, and an enforcement perspective (legitimacy to tax, and possible to enforce taxation)
SUBSTANTIVE TAX RULES: CIT VS VAT

SOURCE VS DESTINATION

CORPORATE INCOME TAX
- SOURCE / REDIDENCE
  - TAX AVOIDANCE / COMPETITION

- DESTINATION

VAT
- DESTINATION
  - LIMITED AVOIDANCE AND COMPETITION
  - "TAX WARS"

- BRAZIL – SOURCE
Legitimacy Considerations

- Is connection sufficiently strong to legitimise taxing rights?
- Are sales not the real origin of corporate income?
- Recent tax scandals involving Starbucks, Amazon or Google highlight significance of this connection
- Not to say that destination is more legitimate than source or residence, but as legitimate as
SUBSTANTIVE TAX RULES
TAX ENFORCEMENT: CIT AND VAT

Revenue Loss

Fraud

Taxpayer Inequity

Distortions to competition

Subsidy to Organised Crime

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CIT
(1) Tax Amnesties
(2) Nudges

VAT
(1) Third-party liability
(2) Formalism
(3) Relaxed enforcement on imports
ENFORCEMENT
From crime control to crime management

Rationale for shift

• Difficulties combating fraud, so “dispense with the problems it poses”
• Costs of prosecuting high-profile cases
• Public finance difficulties AND public perception of companies has resulted in higher tolerance of dubious practices

Evidence for shift

• Excessive formalism, resulting in denial of tax rights
• Size of penalties beyond what would be reasonable as deterrent
• Proliferation of tax amnesties
• Responsibilisation of third parties, even if only remotely connected with fraudster

Risks of shift

• Concerns over public finances used as justification for dismissal of rule of law
• Eliminating revenue costs of fraud deters combat to fraud, leaving other costs untouched
<table>
<thead>
<tr>
<th>Substantive Rules</th>
<th>Enforcement</th>
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<tbody>
<tr>
<td><strong>(P/)CIT</strong></td>
<td>No.</td>
</tr>
<tr>
<td>Ongoing work will not be sufficient to address existing limitations.</td>
<td>Not yet. Progress, but focus on revenue loss only is limiting further progress.</td>
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<tr>
<td><strong>VAT</strong></td>
<td>Yes.</td>
</tr>
<tr>
<td>Great progress achieved in last few years</td>
<td>Not yet. Progress, but focus on revenue loss only is limiting further progress.</td>
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