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Digital Taxes: Multilateral Breakthrough or Falling Through?

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SYNOPSIS

Negotiations for a multilateral tax treaty are ongoing, even as the pandemic diverts political energy and provides pretext for delay. Can countries cobble together a consensus, and in what ways will agreement be meaningful?

COMMENTARY

COVID-19 IS catapulting the digital economy to the fore. Strained state finances, and a booming digital economy amidst social distancing and accelerating connectivity, spotlight the potential of taxing this growing pie.

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State of Play

Originally slated for a December 2020 deadline, the OECD's Inclusive Framework now aims to lock in by mid-2021 global guidelines on taxing multinational enterprises (MNEs) that meet a tentative revenue floor of 750 million euros. *Pillar One* of the Framework would create rules for taxing digitally-enabled businesses that so far pay lower rates, despite a significant economic presence, because they do not have a permanent establishment in host economies. *Pillar Two*, meanwhile, would introduce a minimum tax on MNEs.

The Framework's significance is manifold. *First*, it reflects a longstanding debate over tax sovereignty: states lose out on an estimated US$200 billion per year to tax havens, and have struggled with taxing digital businesses.

Second, it would be an additional revenue stream in the digital economy, considering that the World Trade Organisation's e-commerce moratorium prohibits tariffs on electronic goods, and could contribute to domestic resource mobilisation (Sustainable Development Goal 17.1). In providing some relief to governments, it could ideally mitigate attempts to squeeze revenue from elsewhere, such as increased inspections further straining international trade.

Third, sans consensus, the levying of potentially discriminatory unilateral taxes leaves the door open for disputes. This may prompt retaliatory weaponisation of economic relationships, such as trade, in a global economy already suffering from a short supply of stability and certainty.

Breakthrough or Falling Through?

With much riding on the line, can there be a global consensus?

Familiar challenges beset a resolution. COVID-19 is both fillip and obstacle. As with many international fora, virtual summitry falls short in facilitating informal conversations necessary for diplomacy. Multiple interests, moreover, are a hallmark of multilateral agreements. The Inclusive Framework is no different.

Disagreement arises over scope. It is unclear what MNEs are covered by the Framework. While originally designed to target digital giants, this mainly entailed taxing US MNEs besides a handful of Chinese and European firms — a move Washington decried as discriminatory, despite these MNEs being affected on grounds of being the main beneficiaries of the current rules-based economic system rather than citizenship. Since then, consumer-facing businesses have been added to the list.

There is also debate over whether the Framework should be mandatory. In December 2019, the Trump administration advocated for a Safe Harbour proposal, which would allow firms to voluntarily opt-in for Pillar One.

It is not, however, all doom and gloom. Businesses are willing to comply with a global framework in lieu of a regulatory noodle bowl. Much resistance is concentrated on Pillar One (taxing digitally-enabled businesses), but both the US and developing countries, which usually champion precautionary digital rule-making, have generally approved of implementing Pillar Two (introducing minimum taxes on MNEs) first.

Yet while the OECD's recent economic impact assessment suggests that governments may accrue more fiscal revenue through Pillar Two, many states are pushing for a concurrent advance. Pillar Two alone will not reallocate taxing rights in a digital age. In this sense, it perhaps only partially reflects broader contestations over the spoils of the digital economy.

Security Taxing Multilateralism

To some extent, the digital economy is modifying the interests of different political-economic factions, but also historically like-minded countries such as the OECD membership. Digital taxes are a bone of contention in the US-European Union relations. Europe is now a source, rather than beneficiary, of rents or unearned profits.

Just as Washington under Trump opposes the taxing of its MNEs, which might cut into R&D funding and hence its technological edge, it is in Europe's interest to impose them. Seen in this light, the Trump administration's decision to abandon negotiations in June is perhaps unsurprising.

Some place high hopes for a reversal of fortunes following the US' November presidential election, which is still hanging in the balance at this time of writing. Yet bipartisan consensus and differences with like-minded allies on digital taxes harks back even to the Obama era. It remains to be seen whether a Biden White House augurs well for consensus, even if it could put greater multilateral involvement back on the cards.

Moreover, how much reliability and certainty can a rules-based order proffer if members selectively follow the rules? Heightened national security concerns call into question the meaningfulness of any potential consensus, given a mindset shift in Washington over a fading liberal economic order and threatened American exceptionalism.

This is on top of other security concerns which might blunt the Framework's implementation. For one, it is not clear how tax incentives will impact effective tax rates and hence revenues gained from the Framework; governments see them as a way of attracting investment and protecting economic security.

For another, levying these taxes can depend on exchange of information between jurisdictions. Yet requests for data can be and are rejected on grounds of data insecurity or poor privacy and civil liberty laws. This lack of capacity could disproportionately affect less developed countries in greater need of tax justice.

Way Forward: Reframe Global Negotiations?

Overall, countries could go it alone in the event of talks breaking down. Digital value-added taxes toe legal lines, for instance. But this may be politically tone deaf in a post-COVID world where economic inequalities are front and centre — although corporate income taxes do not negate the odds of costs being passed on to smaller businesses and consumers regardless.

Alternatively, agreement without the US would be defanged considering the market share of American firms and Washington's capacity for inflicting punitive measures.

Forging a consensus will hence be no easy feat, but necessary. It may require treating digital taxes as part of a broader rather than standalone agreement, with compromises on this front being traded for concessions on digital trade.

To that end, putting the national security genie back in the bottle to de-escalate tensions and reframe negotiations will be a critical first step. Still, only time will tell how other spectres of insecurity — whether economic or data-based — might hinder the realisation of a more sustainable global economic system, or a significant shift in power between states and markets overall.

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