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TAXING THE DIGITAL ECONOMY

The research explores the complex territory of taxing the digital economy, examining the challenges and opportunities arising from the application of novel tax measures and advanced tools to digitalise tax administration. In the wake of the evolving technology landscape, traditional tax frameworks face unprecedented challenges in collecting revenue from digital transactions, necessitating a reassessment of tax policy and administration methods. Key challenges include the elusive nature of digital transactions, the difficulty in establishing a fair and effective tax system, and the pervasive problem of tax evasion in the digital economy. To address these challenges, the study examines innovative tax measures and advanced tools aimed at modernising tax administration and promoting economic transparency. In the pursuit of a more transparent tax landscape, the research emphasises the use of these new taxes and tools to incentivise compliance, discourage evasion and promote economic formalisation. In addition, the study examines the OECD's Base Erosion and Profit Shifting (BEPS) 2.0 project, which is playing a key role in shaping the international response to the tax challenges posed by the digital economy. The research assesses the implications, recommendations and potential contributions of the BEPS 2.0 project to a coordinated global approach to addressing the tax issues associated with the digitalisation of economic activity.

Keywords: digital economy, technology, taxation, tax evasion, BEPS 2.0.

1. INTRODUCTION

The advent of the digital economy has revolutionized the way we conduct business, communicate, and exchange goods and services. With this transformation, however, comes a new set of challenges in many areas of our life, and also for tax authorities worldwide. Traditional tax systems, designed in an era where business activities were more tangible and geographically bound, are now grappling with the virtual and often borderless nature of digital transactions (Országgyűlés Hivatala, 2021, p. 1). The digital economy is characterized by its fluidity and the intangible nature of its transactions.

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Companies can operate and generate substantial revenues in jurisdictions without a physical presence, complicating the application of existing tax laws (Slemrod & Weber, 2012, pp. 25–29). This has led to significant challenges in ensuring that tax revenue is collected effectively and fairly. The elusive nature of digital transactions makes it difficult to track and tax them in the same way as traditional commerce (Consilium.europa.eu, 2024). Moreover, the rapid pace of technological advancement often outstrips the ability of tax legislation to adapt, leading to loopholes and opportunities for tax evasion (Slemrod, 2006, p. 3; Khlif & Achek, 2015, pp. 487–492).

In response to these challenges, researchers and policymakers are examining innovative tax measures and leveraging advanced tools to modernize tax administration (OECD, 2013; Perez Lopez, Delgado Rodrıguez & de Lucas Santos, 2019). These initiatives aim to enhance economic transparency and ensure that tax systems remain relevant in the digital age (Varga, 2020).

This study delves into the complex interplay of tax mechanisms within the digital economy, scrutinizing the challenges and opportunities that arise as we move towards more sophisticated tax strategies and the digitization of tax systems. It explores the complicated nature of digital transactions, the obstacles in creating an equitable tax framework, and the prevalent problem of tax avoidance in the digital sphere. Through an extensive examination of progressive tax methods and the adoption of advanced technologies, this research seeks to lay the groundwork for the evolution of tax administration and the improvement of fiscal transparency. As we navigate the intricacies of digital tax reform, the paper also addresses the significant role of the OECD's Base Erosion and Profit Shifting (BEPS) 2.0 initiative in orchestrating a collective international effort to tackle the tax issues brought forth by the digitalization of business. The study assesses the potential impacts, practical suggestions, and notable contributions of the BEPS 2.0 initiative, highlighting the endeavours to establish a harmonized global approach to taxing the digital economy. In essence, this introduction sets the stage for a comprehensive exploration into the necessity of effectively taxing the digital economy.

2. TAX EVASION IN THE DIGITAL WORLD

A “good” tax system is one that achieves the goals of equity, efficiency, and adequacy (Szilovics, 2003, pp. 55–60). Tax evasion—when individuals and firms do not pay their legally due tax liabilities in a timely manner—compromises all of these goals (Alm, 2021, p. 322). Tax evasion can be defined as any criminal activity or any offence of dishonesty punishable by civil penalties that is intended to reduce the taxation incidence, and depends on economic and tax structures, types of income, and social attitudes. The concept of tax evasion in the existing literature has been described from an economic or public finance perspective and very few studies have discussed the issue from a philosophical or ethical viewpoint. The basic theoretical model of tax evasion is a straightforward application of individual choice under uncertainty and the problem an individual faces is whether or not to evade some part of their legal tax liability, given that there is some probability of being caught if they decide to evade. Tax evasion involves

illegal activities such as deliberately not reporting or under-reporting income, falsifying records or invoices, concealing assets or income, engaging in cash economy to avoid leaving a trace of transactions, using offshore accounts to hide income or assets (Saez & Zucman, 2019; Szilovics, 2003, pp. 47–51).

Tax fraud is a broader term that encompasses tax evasion but also includes other fraudulent activities against the tax system, such as submitting false documents or making false claims to the Tax Authority, using or creating fake companies to evade taxes. engaging in VAT fraud, such as carousel fraud or missing trader fraud (Szilovics, 2024, p. 7; Allingham & Sandmo, 1972; Stiglitz, 1969).

The basic issue in tax administration has always been getting information on taxpayers and their activities, and for much of history tax administrations did not have full, complete, and timely information. Even during much of the twentieth century information has been limited, due to several factors. Many transactions were in cash, so that there was no "paper trail" that could be used to verify the accuracy of any reports. Many types of transactions were not reported via third party information, so again, there was no paper trail of transactions. Many types of income were also not subject to source withholding, which also decreased the flow of information to the tax authorities. Many types of tax shelters were shrouded in secrecy. Both companies and individuals hid income and assets in offshore accounts. Many multinationals were able to shift profits to low-tax jurisdictions via transfer prices that were largely hidden and, even when reported, that could not be independently verified. Overall, these factors generated several main strategies for tax evasion during much of the twentieth century. Taxpayers would fail to report all cash receipts and cash expenses on their tax returns; indeed, many individuals would simply fail to file a tax return. The end result was predictable: tax evasion (along with money laundering and tax avoidance) existed, persisted, and flourished in most countries around the world, largely because tax administrations did not have the information necessary to prevent these practices (Zucman, 2013, pp. 1333–1334; Alstadsæter, Johannesen & Zucman, 2019, pp. 2082–2083; Unger & van der Linde, 2015).

Technological improvements and digitalization have influenced the tax collection processes worldwide by improving the speed, quality, and accuracy of the data and changing the ways of reporting, controlling, and auditing the taxes. Tax authorities, policymakers, regulators, accountants, and taxpayers have realized the opportunities of digitalization and started to get benefits from e-services, applications, websites, software, etc. (Slemrod, 2019). Digitalization may reduce tax fraud by enhancing information collection, improving control tools, and increasing efficiency while giving new opportunities for evading the tax (Zucman, 2015; Gupta *et al.,* 2017; Yamen, Coskun & Mersni, 2023).

Digital services taxes (DSTs) have been introduced in several countries to target revenue generated from digital activities, such as online advertising and the sale of user data. DSTs are levied on income derived from online advertising, the sale of user data, and other digital services provided by large tech companies. While DSTs represent a step towards ensuring that digital businesses contribute their fair share of taxes, they have also sparked controversy and debate over their potential to cause trade disputes and market distortions (consilium.europa.eu, 2024).

Next to the DSTs, advanced tools, including artificial intelligence and big data analytics, are being deployed to improve the efficiency of tax collection and combat evasion. These technologies can analyse vast amounts of transaction data to identify patterns indicative of non-compliance. By digitalizing tax administration, authorities can streamline processes, reduce administrative burdens, and encourage voluntary compliance. The use of new taxes and tools is not only about increasing revenue but also about fostering a culture of compliance (Erdős, 2020, pp. 11–12). By creating a more transparent tax landscape, authorities can incentivize businesses to comply with tax obligations and discourage evasion. This approach promotes economic formalization, as companies recognize the benefits of operating within the legal framework, such as access to financial services and legal protections (Avi-Yonah & Clausing, 2019, p. 840).

Certainly, technological advancements are not exclusive to governmental use; they are also within reach of private entities to varying extents. The same tools that enable governments to gather, transmit, and analyse information are equally available to individuals and businesses. Consequently, these technologies bolster the capacity of private parties to conceal their income and assets from tax authorities. Technological developments facilitate profit shifting through transfer pricing strategies, the strategic placement of intangible assets in low-tax areas, the manipulation of internal group debt, treaty shopping, corporate restructuring to exploit tax benefits, and deferring tax liabilities. Additionally, technology simplifies the involvement of individuals and companies in global supply chains, which can be used both to channel profits into tax havens and to participate in tax evasion through mechanisms like money laundering (Alm, 2021, pp. 322–323).

The statistics on global tax evasion (Alstadsæter, Johannesen & Zucman, 2018, pp. 89-100) underscore the extent to which technological advancements have been leveraged by private individuals and firms to evade taxes. These figures highlight the growing challenge for tax administrations worldwide as they attempt to keep pace with the sophisticated methods employed to conceal income and assets. Multinational corporations and ultra-wealthy individuals annually precipitate a global revenue shortfall of $480 billion (Oxfam, 2022) for national treasuries through the minimization of tax liabilities by resorting to tax havens, offshore stratagems, and various other methods of tax avoidance (taxobservatory.eu, 2021). This figure can also be articulated as a critique of local solutions; therefore, in the subsequent chapter, I will examine a global approach initiated by the OECD, which currently constitutes one of the most pertinent subjects within the international tax law milieu.

3. OECD BEPS 2.0

In the context of the blooming digital economy, the nature of global commerce and business has transcended traditional boundaries, creating a pressing need for an international approach to the tax challenges that have arisen as a consequence. The digital economy's global reach has rendered national tax systems inadequate in isolation, calling for a collaborative response to ensure tax fairness and integrity across borders. Recognizing this imperative, the OECD has spearheaded the Base Erosion and Profit

Shifting (BEPS) 2.0 project, a pivotal initiative aimed at reshaping the international tax framework to better align with the realities of a digitalized world (oecd.org, 2024). The OECD's two-pillar project addresses the fair taxation of the digital economy and large enterprises. In response to global tax avoidance, the international community recognized in the 2010s that the fair taxation of digital and large businesses is a global issue that can only be resolved through broad collaboration. To address this issue, the OECD proposed a two-pillar solution: the first pillar aims to ensure the fair taxation of large enterprises with excess profits by proposing a reallocation of corporate tax bases based on the location of users, while the second pillar targets the introduction of a global minimum corporate tax (known as the "GloBe" proposal). The BEPS 2.0 project is a comprehensive endeavour to combat the strategies employed by multinational enterprises that seek to minimize their tax liabilities through base erosion and profit shifting. These tactics often involve exploiting gaps and mismatches in tax rules to shift profits to low or no-tax jurisdictions, thereby eroding the tax base of the countries where the actual economic activity takes place. The project puts forth a robust set of rules and recommendations that strive to ensure that profits are taxed in the jurisdictions where substantial economic activities are conducted and where value is genuinely created.

BEPS 2.0 seeks to redefine the allocation of taxing rights in a manner that reflects the digitalization of the economy. This includes revising the nexus rules to capture the digital presence of businesses and allocating taxing rights that may not be tied to a physical presence, thereby acknowledging the value creation that occurs through digital engagement and user participation in different markets. The project represents a concerted effort to harmonize tax policies on a global scale and to prevent the fragmentation of the international tax system. It embodies the collective will to establish a more coherent, transparent, and equitable tax regime that can withstand the challenges posed by an increasingly digital and interconnected global economy (oecd.org, 2024).

The BEPS 2.0 project is not just a theoretical exercise; it is a significant development in the international tax arena, one that has the potential to fundamentally alter the way multinational enterprises are taxed. By providing a framework for international cooperation, the project aims to prevent the rise of trade tensions and economic distortions that could result from unilateral tax measures.

However, the path to implementing the BEPS 2.0 recommendations is fraught with complexities. Achieving consensus among a diverse array of countries, each with its own unique interests and tax policies is a formidable challenge. There are also concerns regarding the potential impact on smaller economies and the capacity of developing countries to effectively participate in and benefit from the BEPS process. These countries may require additional support to implement the complex rules and to safeguard their tax bases. In the European Union, a directive proposal was prepared based on the OECD Model Rules, which was intensively negotiated throughout 2022. Following the lifting of Hungary's veto on the global minimum tax directive in December 2022, the Council Directive (EU) 2022/2023 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic enterprise groups in the Union (the "GloBE Directive") was adopted. Member States were required

to implement the GloBE Directive by 31 December 2023. The majority of the global minimum tax rules must be applied by all Member States, including Hungary, for financial years beginning from 31 December 2023, with some rules only applicable for financial years starting from 31 December 2024.

Non-EU European countries, as the United Kingdom and Switzerland have implemented the rules so far. The United Kingdom will apply the global minimum tax rules from 2024. Switzerland initially planned a full implementation in 2024; however, in December 2023, it decided to introduce only the domestic top-up tax (QDMTT) from 2024, with the other rules to be applied from a currently unknown future date. This decision was justified by the delay in implementation by significant third countries—USA, China, Brazil, India. Among other third countries, Japan will apply the income inclusion rule (IIR) for financial years following 1 April 2024, but is postponing the introduction of the domestic top-up tax (QDMTT) and the undertaxed payments rule (UTPR) to an uncertain future date. Canada and Australia will also apply global minimum tax rules from 2024, but information on the rules is limited. The USA, China, Brazil, and India will not introduce global minimum tax rules from 2024, and it is uncertain when they might do so.

Among African nations, Nigeria, Zimbabwe, South Africa, and Mauritius have previously indicated that they are considering the possibility of implementation; however, a general tendency to wait and see prevails across the continent. These countries operate extensive tax incentive schemes for multinational corporations, and thus the introduction of a global minimum tax—regardless of progress made by other countries—may only become timely after a prior transformation of the tax incentive system, whose effects could be neutralized by the global minimum tax. A similar mindset is observed in developing Asian countries. Among Asian nations, South Korea and Vietnam have adopted global minimum tax rules to be applied from 2024, with Thailand planning to do so from 2025, followed by Singapore, Hong Kong, and Malaysia. The rest of the Asian countries, much like the South American continent, maintain a position of expectancy (ado.hu, 2024).

The implementation of global initiatives is fraught with complex challenges, as the distinct political, economic, and cultural landscapes of various countries can significantly influence the successful execution of these projects. This is particularly true for projects under the auspices of the OECD, where substantial disparities exist among member states in these factors. With the BEPS projects, we focus on how to eliminate the tax loopholes exploited by multinational corporations, and lay the foundations for a new international tax system in corporate taxation, dealing with the challenges of the digital economy. However, there is a growing debate that these initiatives do not address the tax avoidance practices of individuals at all (Beretta, 2019, pp. 68–69).

4. CONCLUSIONS

In conclusion, this research has illuminated the intricate dynamics of taxation within the digital economy, highlighting the urgent need for innovative tax measures and advanced tools to modernize tax administration and foster economic transparency. The study has underscored the significance of the OECD's BEPS 2.0 project as a cornerstone

in the development of a coordinated global response to the tax challenges presented by digitalization. As nations grapple with the implementation of these initiatives, the journey towards a more equitable and effective international tax system continues, with the hope of bridging the gaps that allow for tax evasion and ensuring that the digital economy contributes its fair share to public coffers. The findings of this research serve as a clarion call for ongoing collaboration and adaptation in the face of an ever-evolving economic landscape.

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