TAXATION OF DIGITAL COMPANIES – CURRENT STATE AND PROSPECTS

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Abstract: *Globalisation and the spread of new information and communication technologies has led to the creation of a strong digital sector of the economy consisted of companies specialised in the provision of remote services based on online platforms. The taxation of the profits of digital companies has proven to be a significant challenge to the public sector but nevertheless different solutions have been implemented around the world. The present paper has as its objective to outline and analyse the existing national approaches towards the taxation of the companies specialized in the provision of digital services. It is stated in the paper that unilateral fiscal measures increase tax uncertainty and add to complexity of national tax systems.*
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1. Introduction

The process of digitialisation has been related to a rapid spread of new information and communication technologies throughout the world in the past three decades. On the one hand, these developments have improved the conditions for international competition and created new possibilities for economic growth and social prosperity. On the other hand, digitalisation has added new challenges at the microeconomic and macroeconomic levels. The OECD has recognised that these changes have brought with them challenges to the rules for taxing international business income, which have prevailed for more than a hundred years and created opportunities for base erosion and profit shifting (BEPS), requiring bold moves by policy makers to restore confidence in the system and ensure that profits are taxed where economic activities take place and value is created (OECD, 2024, p. 3).

2. Challenges to the taxation of the companies specialised in the provision of digital services

2.1. Characteristics and importance of digital businesses

Technological development and the spread of internet throughout the world have led to the creation of new types of business models based on online platforms. There is no single definition of the digital economy and business models. Nevertheless, a digital business can be defined as the process of applying digital technology to reinvent business models and transform a company's products and customer experiences - innovating products that create new value and connecting people with things, insights and experiences (Cognizant, 2024).

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According to Arthur (2011, cited in Aagard, ed., 2019, p. 1), digitalisation is creating a second economy that is vast, automatic and invisible, thereby bringing about the greatest societal upheaval since the Industrial Revolution.

As Requena (2017) pointed out, the adjective "digital" lends added innovation to the traditional term "economy". This novel economy is conducted by digital means, mainly charecterised by the lack of physical contact between the acting parties, and the digitalisation of the information regarding the goods and/or services subject to trade.

Becker (2021) pointed out that the digital economy includes platform-supported services such as Uber, online platforms such as Amazon, Facebook, and Google, trading electronic services such as e-books, video games, and films as well as online delivery of software and mobile-enabled technologies and applications (cited in Mpofu, 2022, p. 3).

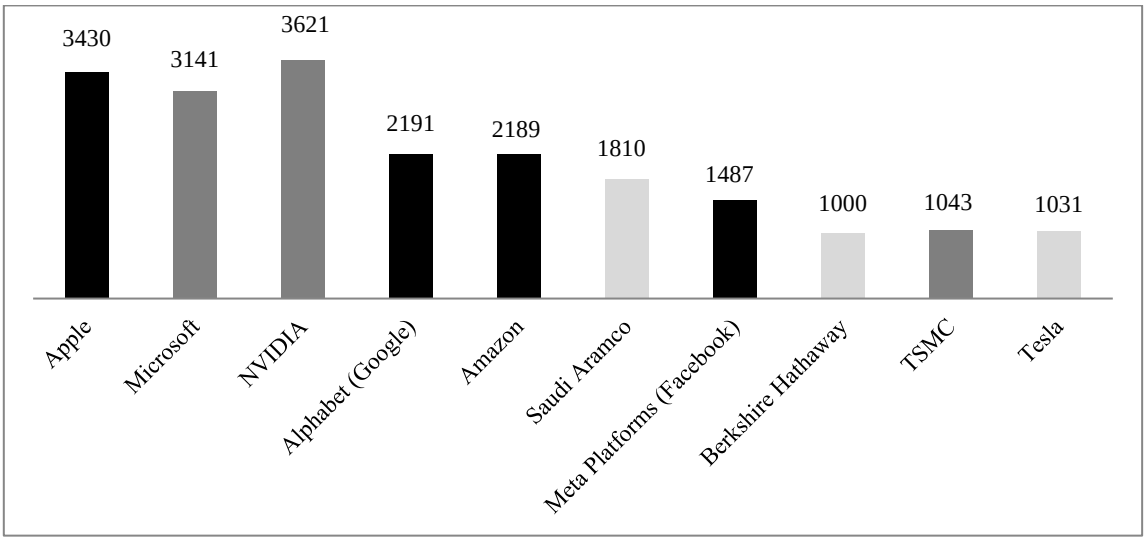
Through the use of remote technology, many digitalised businesses can effectively be heavily involved in the economic life of different jurisdictions without any, or any significant physical presence, thus achieving operational scale without mass (OECD, 2018, p. 51).

In practice, digitalisation is seen in the dramatic shift in focus toward marketing online, on social media and via mobile marketing, and a decreasing focus on traditional advertising. Stronger interactions are created and data is continuously collected from existing and potential customers through social networks (Aaagard, 2019, p. 2). These new business models contradict the prediction of a massive disintermediation caused by the strong development of digital technologies and of the Internet. Even if the Internet can reduce coordination costs, intermediaries are still needed (Brosseau and Penard, 2007, p. 82).

The Organisation for economic cooperation and development (OECD) has defined three salient features that are frequently observed in the business models of some highly digitalised firms: cross-jurisdictional scale without mass, heavy reliance on intangible assets, especially intellectual property (IP), and the importance of data, user participation and their synergies with IP. At the same time, it has been recognised that these characteristics are not exclusive to highly digitalised business models. They can also be found to varying degrees, in more traditional business models, and have gained greater prominence as a function of globalisation more generally. The third feature, data and user participation, is more evident in a subset of highly digitalised business models (OECD, 2018, p 170).

Due to the fact that information and communication technologies (ICT) have become an integral part of most economic sectors, the companies that are specialised in the provision of digital services have grown immensely over the past two decades.

Figure 1. Top 10 global companies by market capitalisation in November 2024 (in USD billions)



Source: Companies Market Cap

2.2. Projects for internationally coordinated solutions towards digital companies

The increase in digital transactions poses a remarkable challenge for tax authorities (Mpofu, 2022, p. 1). The internationally accepted rules on corporate income taxation date back to the 1920s which means that the applicable legislation towards company profits falls behind the technological developments in the digital area. The main two questions are: first, how to tax the income of the companies specialised in the provision of digital services such as Alphabet, Meta or Amazon and second, how to allocate the taxing rights between the source and the residence country. At the same time, OECD has admitted that it is impossible to "ring-fence" the digital sector from the rest of the economy.

From a fiscal point of view, the exclusion of the largest digital companies from taxation implies a loss of significant fiscal revenue for the countries where these enterprises operate. In this way, it leads to inequalities in the tax burden of traditional and digital business models (Geringer, 2021). This in turn puts digitalised business models at an unfair competitive advantage, thus distorting market conditions. In an international context, an important result of digitalisation is the double non-taxation of corporate profits of the respective companies. The double non-taxation does not necessarily arise from tax evasion or avoidance, but rather from the lack of adequate tax rules towards the income earned from the supply of digital services; therefore, this problem can be solved through modernisation of the tax regime, preferably involving the countries where large MNEs are headquartered. Furthermore, digitalisation itself opens new opportunities for tax avoidance on the part of MNEs through profit shifting to jurisdictions with low tax rates or even no direct taxes at all. Finally,

In recent years, there have been several international initiatives for the introduction of taxes towards the earnings of the MNEs specialised in the provision of digital services. A coordinated response, including the introduction of a concept of *digital permanent establishment*, has been the preferred approach by the European Union (Popova, 2020, p.). In 2018, the EU presented a draft directive on the corporate taxation of significant digital presence. The objective of the Commission's proposal was to extend the concept of

permanent establishment so as to include a significant digital presence through which a business is carried on and establish rules for the attribution of profits generated through such significant digital presence (Eur-Lex, 2018). In parallel, the EU also put forward a draft directive on the common system of a digital services tax (DST) as an interim measure until the achievement of a global consensus towards the taxation of the digital economy. According to the draft, the DST at a rate of 3% would be levied on the gross annual revenue from the provision of three types of digital services: first, the placing on a digital interface of advertising targeted at users of that interface; second, making available to users of a multi-sided digital interface which allows users to find other users and to interact with them, and which may also facilitate the provision of underlying supplies of goods or services directly between users; and third, the transmission of data collected about users and generated from users' activities on digital interfaces. The tax would apply only to companies with a total gross annual turnover exceeding 750 million euro and a gross turnover in the EU over 50 million euro (Eur-lex, 2018a). The two proposals did not obtain the necessary unanimity of the Member States, thus they were not implemented.

The Base Erosion and Profit Shifting (BEPS) Project, launched in 2013 by the OECD and G20, has been the most ambitious initiative on the global level for reforms of corporate income taxation rules in recent decades. As of 2024, over 140 countries are participating in the BEPS Project through its so-called Inclusive Framework. The main goal of the project is to modernise company taxation rules and adapt them to the context of globalisation and digitalisation, thus limiting the possibilities of multinational enterprises (MNEs) to avoid taxes through profit shifting strategies. The BEPS Project consists of fifteen actions each of which is targeted towards a particular issue.

Action One of the BEPS Project is particularly focused on the challenges arising from digitalization and the measures within its framework have been divided into two pillars. As regards Pillar One, the proposed reforms under the BEPS Project do not contain a change in the definition of “permanent establishment”; rather, they introduce a new formula-based mechanism for allocation of the taxing rights among countries with regard to the taxable profits of the companies concerned (instead on the basis of transfer prices). Its application will be limited only to a share of the residual profit, if the amount so allocated is over and above the arm’s length return that might be allocable to in-market activities such as baseline marketing and distribution (OECD, 2020, p. 9). The timing for the introduction of Pillar One is unknown and depends on its acceptance by a critical mass of jurisdictions (KPMG, 2024a). Pillar Two on its part involves measures intended to reduce the incentives of digitalised MNEs to shift their profits to low-tax jurisdictions. Its essence consists in the application towards large MNEs with revenues above EUR 750 million of a 15% effective minimum tax rate wherever they operate.

The implementation of the global minimum tax has progressed with around 55 jurisdictions already taking steps toward implementation and with the rules coming into effect in 2024. In the EU, Council Directive (EU) 2022/2523 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union was adopted by the Member States and entered into force on December 23, 2022. The Directive requires Member States to transpose the rules into domestic law by December 31, 2023 (KPMG, 2024).

It should be noted that the global minimum tax is applicable to all MNEs with turnover above the set threshold and not only to the companies specialised in the provision of digital services. This tax can be viewed more as an attempt to curb aggressive tax planning rather than to tax the profits of digital companies. This means that the adoption of the global minimum does not require abolishment of the national digital taxes introduced by some countries.

Cantos (2022) found fundamental reasons for not having an optimistic view on the effective solution to the problems above: unrealistic forecasts on the amount of the new estimated tax bases for Pillar One and the high administration and compliance costs. In conclusion, it is not foreseeable that the tax bases derived from the provision of digital services will suffer a territorial redistribution. We do not expect that a minimum tax rate of 15% in corporate tax will be carried out effectively or that the benefits that are transferred to tax havens will be significantly reduced.

On the basis of an empirical study, Johannesen (2022, p. 7) concluded that the welfare effect of a global minimum tax is unambiguously positive when the tax rate is high enough to end profit shifting. This author pointed to the risk of introducing a global minimum tax at a low rate where profit shifting continues and havens capture part of the global revenue gain associated with the policy.

Initially, it was envisaged that the new rules within BEPS Action One mechanism for profit allocation would be applicable only to large MNEs and under the conditions that these companies provide automated digital services and the revenue is generated from the sale of goods and services only to final consumers. However, in the latest draft of the proposed reforms the scope of covered businesses has been changed from the original intention of highly digitalised business models. However, due to difficulties in "ring-fencing" the digital sector of the economy, the scope of the proposed reforms under both Pillar One and Pillar Two has been extended to include all large multinational companies regardless of the industry in which they operate. Although extractives and regulated financial services are exempt, all other industries are generally in scope of the rules under Pillar One (KPMG, 2024a). Thus, the measures within Action One of the BEPS Project are no longer focused specifically on the companies specialized in the provision of digital services, rather they target tax avoidance by MNEs and race-to-the-bottom among countries in the area of corporate income tax.

In the near future, revising the determination of transfer prices is one of the key challenges in designing an administrable system of profit taxation with a minimum of distortive efects for digital business models (Olbert, Spengel, 2017, p. 5)

3. National approaches towards the taxation of digital companies

The difficulties for a consensus-based solution towards the taxation of the digital economy within OECD/G20 and the EU has led to the introduction of unilateral tax measures towards digital businesses by a number of countries throughout the world. Digital tax policies have targeted MNEs such as Facebook, Google, and Amazon, web-based services as well as other e-commerce marketplaces to widen the tax base by extending existing legislation to new

players or directing new tax legislation specifically to new businesses and platforms that were previously not subjected to tax (Mpofu, 2022, p. 4)

On the basis of a comparative analysis of a number of countries, Strauss et al. (2023) found that although the recommended interim tax measures (where applicable) were adopted in principle by the majority of countries worldwide, the application of these measures lacks uniformity.

As of 2024, around fifty countries have adopted or announced the implementation of direct taxes on digitalised companies (KPMG, 2024). Although significant differences exist with regard to the organisation of the specific tax measures in individual countries, some commonalities can be observed. Below are presented the five main types of unilateral approaches towards the digital sector with their characteristics as well as other tax measures. Table 1 gives more detailed information regarding some of the countries that have introduced some of these tax measures towards the companies specialised in the provision of digital services.

- *Digital services tax (DST), including digital advertising taxes (DAT)*

As of 2024, taxes on the provision of digital services have been adopted by a number of countries throughout the world, including Belgium, Canada, France, India, Italy, Kenya, Turkey and others. In most countries, the tax follows the parameters set within the EU proposal from 2018, especially regarding the scope and rates of taxation. Table 1 gives information about the DSTs already implemented in selected countries. Generally, the tax rates are low (between 1% and 3%) with Turkey being an exception with a relatively higher tax rate. The digital services typically subject to taxation are targeted online advertising, the sale of user data generated in online platforms to third parties as well as online platforms for sales of goods.

Both in the literature and in practice DSTs are classified as "hybrid taxes" because they combine elements of income and consumption taxes (Geringer, 2021, p. 4). Although their goal is to help to level the playing field and function as a substitute for corporate taxation, national, DSTs are linked to the provision of digital services. Since consumption is calculated using gross revenues excluding the VAT, digital taxes are prone to be passed on to customers (Ibid, p. 4).

In several countries, such as Austria and Hungary the scope of digital taxes is limited only to the revenue from online advertising. Like national DSTs, the national DATs are based on gross revenues excluding the VAT (Geringer, 2021, p. 5).

- *Withholding tax (WHT)*

The introduction of withholding taxes is also among the prevalent approaches towards the earnings of digitalised companies. Traditionally, such taxes are used by governments as a method to collect revenue from foreign businesses. In particular, withholding taxes have been applied to cross-border interest payments, dividends, and royalties. In recent years, some countries have extended their application to payments for software and other digital services (Forbes, 2024). As can be seen in Table 1, withholding taxes have been enacted in India, Kenya, Malaysia, Mexico Slovakia and other countries. There exist some differences with regard the scope and rates among the individual countries.

- *Digital permanent establishment rule (digital PE)*

One of the possibilities to tax the profits generated in the digital sector of the economy involves an extension of the definition of permanent establishment, thus giving source countries the right to tax on their territory the profits generated through remotely provided services. A traditional permanent establishment requires a physical presence, whereas a DPE focuses on economic presence and significant digital activity Homa (2024, p. 29). As of 2024 several countries have introduced such changes in their legislations that require from foreign companies selling goods and/or providing digital services to pay taxes in the same manner as "traditional" brick-and-mortar businesses (See Table 1). According to Homa (2024, p. 24) the concept of digital PE is the answer to the challenges posed by the digital economy, where companies can generate significant revenues in countries where they have no physical presence. However, the successful realisation of digital PE may encounter some administrative and technical obstacles. In particular, the precise rules and mechanisms for measuring the digital presence in a given jurisdiction and subsequently allocating profits must be determined (Ibid, p. 29). Furthermore, in order to be effective such update of the definition of permanent establishment should be applied on a worldwide basis (Popova, 2020, p. 4). Otherwise, the idea of a digital PE would collide with provisions in existing double tax treaties (Geringer, 2021).

- *Other tax measures*

Such measures cannot be attributed to some of the groups above either because they are targeted at a particular type of digital service or their organisation differs from that of the taxes presented above. Among these other tax measures are the streaming tax (Canada), the general income tax on digital tourist rental services income (Costa Rica and Greece), the cultural contribution levy (Denmark), the general income tax on digital income (Kenya), the equalisation levy (India) etc.

Table 1. Applicable direct tax measures towards digital businesses in selected countries as of 2024

Type of tax measure	Countries	Scope	Rate
Digital services tax (DST), incl. digital advertising tax (DAT)	Austria (DAT)	Gross receipts from advertising services rendered by service providers in Austria with global gross receipts of Euro 750M or more, and turnover in Austria from online advertising services of at least Euro 25M.	5%
	Canada (DST)	· Certain digital services that rely on engagement, data, and content contributions of Canadian users; · Certain sales or licensing of Canadian user data.	3%
	France (DST)	· Provision of digital interfaces enabling users to interact with each other; Provision of services to advertisers which aim at placing targeted advertisements on a digital interface	3%
	Hungary (DAT)	Net turnover for the financial year generated by the broadcasting or publication of advertisements in Hungary.	7.5%
	Italy (DST)	· Advertising on a digital interface; · Multilateral digital interface that allows users to buy/sell goods and services; · transmission of user data generated from using a digital	3%

		interface	
	Kenya (DST)	Gross revenue from provision of a digital marketplace, electronic data management, provision of search engine and other digital services.	1.5%
Withholding tax (WHT)	Malaysia	Any income in relation to e-Commerce transactions is deemed to be derived from Malaysia if it is associated with any activities in Malaysia.	Variable
	Pakistan	Payments for offshore digital services, such as online advertising, designing, creating, hosting or maintenance of websites, etc., performed by nonresident persons.	5%
	Slovakia	Payments to foreign digital platforms facilitating transport and lodging services in Slovakia, acting as a marketplace for such services, not registered as a PE in Slovakia.	5%
	Taiwan	Payments to foreign providers for online advertisement and remunerations for eservices, such as online games, videos, audio broadcast, online platform services, etc..	Variable
	Uruguay	Income of non-residents from services related to businesses involved in the digital economy in Uruguay.	12%
	Vietnam	Income derived by non-residents from digital and e-commerce operations in Vietnam	Variable
Digital permanent establishment (Digital PE)	Belgium, Colombia, India, Indonesia, Israel, Nepal, Pakistan	Taxation of the revenue related to the digital PE.	n/a
OTHER TAX MEASURES			
Tax liability for tourist rental services	Costa Rica, Greece	Income from the provision of rental services via the internet.	
Streaming tax	Canada	Requires online streaming services to contribute a percentage of their Canadian revenues to support the Canadian broadcasting system.	5%
Cultural contribution levy	Denmark	Gross receipts of digital streaming services in Denmark. The proceeds will go to support both Danish public broadcasters and Danish filmmakers.	Variable
Equalisation levy	India	Gross revenue from online advertising payments to overseas platforms, provision of digital advertising space. Only applicable to business-to-business transactions.	6%

Source: KPMG (2024)

Initially, it was foreseen that unilateral digital services taxes and other similar measures were to only temporary until a consensus-based solution within the BEPS Project is reached. However, considering the slow progress of reforms at the global level and the fact that the measures already agreed under BEPS Pillar Two are not specifically targeted towards digital business, we can assume that national taxes of digital companies will remain for a long time. Probably, over the next years more countries will resort to unilateral measures in order to raise the revenue necessary for covering the growing public expenditure. As Stollsteiner (2024) has noted, the introduction of digital taxes aims to recoup some of the lost tax revenue, but it comes at the cost of unilateralism that is damaging to the international tax environment.

4. Conclusion

Finding solutions to the taxation of the profits generated in the digital sector of the economy has proven to be a difficult task because of the specifics of electronically provided services. The overview of existing unilateral fiscal instruments towards the taxation of the digital sector of the economy has confirmed the significant diversity of national approaches. On the one hand, the introduction of national digital taxes is justified on the grounds of fiscal sustainability and achieving fairness in the area of business taxation. On the other hand, the existence of various approaches towards digital taxation in individual countries pose serious challenges to the companies with international activities. The "patchwork" of national tax approaches increases tax uncertainty and compliance costs for businesses and adds to the complexity of tax systems. Despite the difficulties in "ring-fencing" the digital sector of the economy, international coordination in this field is required in order to accomplish effective and efficient taxation of the companies specialised on the provivsion of digital services.

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