

Analysis and Enlightenment of Reshaping International Tax Order under the Background of Economic Digitization

Qi Zeng^{1,*}, Ning Zhu²

¹School of Public Finance and Economics, Shanxi University of Finance and Economics, Taiyuan, 030012, China

²School of Public Finance and Taxation, Zhongnan University of Economics and Law, Wuhan, 430073, China

Abstract

The current international tax rules are not fully adapted to the new trend of the booming digital economy. Meanwhile, due to the slow progress in reshaping the multilateral tax order, some unilateral measures have been taken one after another. This article is based on the OECD solve the transfer of profits tax base erosion and the backbone of a - modify the coupling degree and profit distribution rules, the in-depth analysis of user participation, marketing type of intangible assets, and significant economic exist three proposals on the basis of the proposed the improvement of the ability to ascend suggested multinational tax governance in China: careful research situation of digital economy in China, with the help of a "significant economic existence" reconstruction tax sources allocation rules, timely development of the "tax withholding income tax", help digital enterprises to expand overseas markets.

Keywords

The digital economy; Digital tax; Value creation; User participation; Withholding income tax.

1. Introduction

In the context of digitization of economy, digitization of trade and global value chain, new business models are featured by externalization, decentralization, invisibility, liquidity, concealment and dependence on data. The dynamic process of value appreciation is endlessly subdivided, and the value-creation model extends from the value chain (consisting of basic activities and supporting activities) to value stores (such as personalized business consulting services) and value networks (converting physical intermediaries into digital network intermediaries). In addition, the basic elements in the process of value creation are no longer limited to traditional elements such as natural resources, infrastructure, land, network, technology, knowledge, patents and labor force, but also include emerging elements such as users and markets. This puts forward a series of challenges to the current international tax order operation and the traditional transnational tax source distribution model. First, the original central entity is decoupled from value creation. Even if there is no entity in the market country, digital enterprises can carry out virtual trade across time and space constraints. This has led to the invalidation of the traditional rules for the determination of permanent bodies, including the untimeliness of specific immunity provisions and excessive reliance on physical existence. Second, the line between goods and services becomes blurred, making it difficult to quantify the precise amount of revenue from the sale of highly digital products (revenue or royalty?). The third is the failure of transfer pricing management under the principle of independent transaction, including the difficulty in obtaining comparable transaction prices,

the obstacles in the functional evaluation and analysis of intangible assets, and the possible risks of tax base erosion and profit transfer under special business arrangements.

Based on appeal analysis, the reshaping of the distribution mode of cross-border tax sources under the guidance of the principle of value creation has become the focus and difficulty of the global "tax game". Therefore, this paper will start with three proposals of OECD and the practice of unilateral digital service tax to try to find concrete solutions to the challenges of economic digital taxation in China. (Refer to OECD.Addressing the Tax Challenges of the Digitalisation of the Economy,Public Consultation Document[EB/OL] for details.)

2. International Response to Reshaping the International Tax Order

2.1. OECD Recommendations for Amending the Linkage and Profit Distribution Rules

Value creation is the core of the principle of connection and profit distribution under the traditional model. Generally, the demand side of the product, namely the actual consumer, is regarded as the source of value of turnover tax, so it has the corresponding tax right. Turina A (2019) believes that there are two inherent problems and challenges in the reform proposals currently under consideration. The first is to incorporate the concept of "value creation" into the existing framework of international rules based on "source" and "residence". The second is the gradual transition from the initial "supply" to the combination of "supply and demand".

2.1.1. User Participation

The "user participation" proposal was proposed by the UK. Under the proposal, companies that conform to the traditional principles of correlation and profit distribution will maintain their original rules. Social media platforms, search engines, online shopping malls and other highly digital enterprises with a large number of active users should take the real, continuous and active participation of users as the standard to distribute profits in the market countries, even if there is no physical presence in the market countries. In the distribution of profits, the first step is to calculate the regular profits according to the principle of independent trading; The second step is to allocate residual profits according to certain standards or agreed proportions and find out the part that belongs to user value creation. Third, the distribution is based on certain criteria or identified elements (business revenue, etc.) in each country where the active user is located. As far as the profit distribution model of "user participation" is concerned, it does not change the profit amount of original normal economic activities, but only adds user factor when distributing surplus profits, which is a limited change within the original rules.

The OECD has proposed the introduction of a "Digital Permanent Establishment (PE)", or Digital Permanent Establishment, to delineate international tax jurisdictions. However, whether this "digital PE", the so-called place of value creation, is for users to participate in, has been a matter of disagreement. Liao Yixin, Gong Ting (2019) argue that due to the fuzzy concept of value creation, to user participation can't and the value creation, namely the user participation as international taxation interests division standard and stresses on the expansion of sources of tax revenue jurisdiction is not the same concept (User participation as tax location, refers to the user actively continue to participate in as a standard in the scope of the value creation associated with, regardless of whether the service fee. Because the user data provided may be both conscious and also may be unconscious.). In fact, the tax jurisdiction based on the value creation criterion is to expand the tax power of the country where the consumer is located, and the main problem is that the final consumer of the product is not exactly the same as the user of the digital platform enterprise.

2.1.2. Marketing Intangibles

"Marketing intangible " is proposed by the United States. The proposal is to establish a link between marketing intangible assets and their associated risks and where the market is located. Gao Jinping (2019) points out that this internal connection is embodied in two aspects. First, the hearts of customers for the brand, business love; Second, some information about users in the country where the market is located, such as lists, data, relationships, etc. These internal relations constitute the marketing of the enterprise intangible assets. The common feature is that the value of marketing intangible assets is created or derived by users in the country where the market is located. This proposal applies more broadly, not only to highly digital enterprises, but also to digital enterprises in general. The specific distribution model is different from "user participation", and the core lies in how to accurately distinguish marketing intangible assets from other factors of production that generate income, so as to determine the degree of contribution of marketing intangible assets to income. According to zhu Yansheng (2019) 's interpretation of the specific distribution method, the first method, based on the residual profit segmentation method, first calculates the profits that should be distributed between conventional profits and other factors of production. Secondly, calculate the residual profit and attribute all the residual profit to the marketing type intangible assets. Finally according to the income or other criteria in the user's country of distribution; The second is based on transfer pricing and adjusts its pricing according to the difference between the established marketing intangible assets and the assumed allocation to the market country. It is not only applicable to the profit distribution under the transfer pricing rules of traditional enterprise r&d technology-based intangible assets, but also applicable to the profit distribution of digital enterprises.

Unlike "user participation" proposals, "marketing intangible assets" can be neutral between companies with varying degrees of digitisation. The weakness of this proposal, however, lies in its focus on domestic linkages and its high complexity. As "marketing intangible assets" puts forward high requirements on the tax supervision capacity of the market country, it remains to be seen whether the tax collection cost can be effectively reduced while the tax collection benefit can be maximized. In this regard, Zhu Yansheng (2019) believes that even if the "marketing intangible assets" proposal does not take the degree of digitalization as the standard, it is only applicable to the manufacturers facing the end consumers, causing tax differences among different types of enterprises. It is worth noting that under the mode of "significant economic existence", taxable subjects are not affected by their own digitalization degree, nor by the type of industry they are engaged in, which can effectively solve the problem of "distorting competition".

2.1.3. Significant Economic Presence

"Significant Economic presence" is derived from the OECD's final report of the 2015 action Plan, which is a deepening and innovation of the criteria for classifying permanent institutions. The proposal to transform the traditional significance and tangibility standards for the purpose, and persistence, or if a non-resident enterprise under the premise of continued to generate revenue, with a certain or some users, the purpose of economic interactions are the non-resident enterprises exist significantly in the region economy (Gao Jinping (2019) pointed out that to consider income and other factors, so as to confirm whether a significant economic exist. For example, users and relevant data, using local currency pricing or collection and use of local website, provide after sales service or maintenance, continuous promotions, etc.). This proposal puts more emphasis on the substantial correlation of economic activities, and its profit segmentation model is different from the former two. It is proposed to adopt a "proportional allocation" (piecemeal allocation) method, in which the tax base is calculated based on revenue and global profit margins, and then apportionment is made based on factors such as sales, assets, employees, users, etc.

2.2. Unilateral Digital Services Tax

In October 2018 and July 2019, the UK and France proposed their own unilateral solutions, both modeled on the transitional solutions proposed by the EU in 2018. Clearly, without an OECD consensus on the introduction of digital taxes, these countries or economies are rushing to take unilateral measures against very large digital enterprises.

Digital tax only applies to the super-large Internet giants. It is a unilateral and special policy, rather than a practice of reshaping international tax rules on a global scale. It has its own contradictory problems in terms of tax fairness. First, its essence is to spin off highly digitized enterprises for taxation, which is equivalent to giving tax preferential treatment to small and medium-sized and start-up digitized enterprises in a disguised way, forming a certain trade protection and violating the so-called Ottawa tax framework (One of which is the principles of effectiveness and fairness.). However, such unfair unilateral measures can solve in a short time the long-term situation and dilemma of large network technology enterprises double taxation, and relieve the financial pressure of the countries where users are located. Second, from the perspective of effective tax rate, traditional industry enterprises in the EU reach 23%. Compared with large technology companies only 9.5%, less than half of the traditional industry, it is widely believed that the tax is too low. (http://www.ctax.org.cn/sszh/201912/t20191226_1093648.shtml) The digital tax under the user participation rules can make up the tax difference between digital enterprises and traditional enterprises, which to some extent promotes the fair game between different types of enterprises. Third, from a macro point of view, the measure creates a difference in tax jurisdiction between the country of digital service provider and the country where the user is located. Specifically, the tax jurisdiction of the country where the user is located is expanded, while the tax jurisdiction of the country where the digital service is provided is narrowed, while other enterprises that do not meet the conditions of digitization are equivalent to the exemption treatment of the country where the user is located.

According to Kofler G & Sinnig J (2019), unilateral "equilibrium tax" violates the long-term principle and historical consensus that tax on transnational corporations should be based on profits rather than turnover. However, in order to avoid complex profit accounting process and recognition by permanent institutions, the established unilateral digital tax mostly adopts the method of directly taxing business income, and does not adopt the OECD profit distribution advice. For example, France has made clear that taxes are levied on the basis of turnover and the taxable income is divided in a way that directly determines the percentage related to the participation of French users. Rather than working out the value generated by users around the world and then distributing it among countries according to certain criteria. Although the UK plans to tax surplus profits in its consultation draft of THE UK Digital Services Tax, the feasibility and effectiveness of this distribution model remains to be seen. It is very difficult to figure out exactly how much surplus profit should be distributed, and it is also very difficult to divide the surplus profit reasonably in the countries where each user is located. In addition, in essence, it is not entirely right to tax all value creation done with user participation, but to tax it only when user participation becomes a core element. However, the unilateral digital tax initiative ignores this important principle and takes the approach of taxing income directly. Therefore, the rationality of unilateral digital tax only as a transitional means is still unknown, not to mention as a long-term solution to the problem of tax division.

3. Conclusion

3.1. Prudently Study the Development Status of China's Digital Economy

As the basic status quo of China's digital economy is obviously different from that of the European Union and other economies, the necessity and feasibility of the introduction of digital

tax should be studied carefully. First, China's digital economy industry is still in its infancy, and it is in urgent need of policy preference and support. Therefore, domestic digital enterprises in the rising period should be encouraged and protected, and policies should be given in terms of platform construction and core technology investment, to achieve the purpose of encouraging innovation, stimulating employment and conserving tax sources. Second, the current direction of China's macroeconomic policy reform is still focused on reducing taxes and fees, and the pursuit of fairness should not abandon the consideration of the efficiency of economic activities. Thirdly, the provision and consumption mode of digital services are completely different from offline physical objects. The concealment and invisibility of transaction subjects, the lightness and virtualization of assets pose great challenges to the collection and management capacity of tax authorities. If we cannot effectively realize the efficient flow of "information flow" and "capital flow" on the basis of reducing the cost of collection, it is bound to lose more than the gain. Even though China should not blindly levy digital tax at present, it should still actively respond to the challenge of digital economy to China's tax governance system. When countries all over the world adopt withholding income tax form to avoid the loss of tax sources, we should be prepared. Since the traditional "withholding tax" does not include the income of non-resident enterprises from digital services in China, a certain "withholding tax" can be levied on the users of digital platforms at a lower tax rate on the basis of the total income.

3.2. Reconstructing Tax Source Allocation Rules with the Help of "Significant Economic Presence"

According to the Regulations of the People's Republic of China on the Implementation of the Enterprise Income Tax Law as amended on April 23, 2019, article 2 of the Enterprise Income Tax Law refers to the institutions and sites of non-resident enterprises engaged in production and business activities within the territory of China. Under the traditional economic model, whether goods or services are sold, they are closely connected with the physical existence of "institutions and places". Therefore, actively adapt to the right of tax and profit based on the rule change attitude, from the Angle of domestic law emphasizes the important role of "significant economic existence" (user participation "and" marketing model of intangible assets "is to transfer part of the profits to the countries of market allocation, is under the existing rules of corrections. And" significant economic existence "will change essentially significant physical existence criteria, to establish enterprise and the market of contact.). In order to protect the tax interests of China as a consumer country to the greatest extent, the provisions of "virtual institutions and places" are added. In terms of how to define "virtual institutions and places", we can refer to the "significant economic presence" proposal and use "purposefulness" and "sustainability" as the criteria for determining the economic relevance between non-resident enterprises and Chinese users. That is, if a non-resident enterprise maintains purposeful economic interaction with some Chinese users through digital means, it can be identified that the non-resident enterprise has a "virtual institution or place" in China.

3.3. We Will Help China's Digital Enterprises Expand Overseas Markets

China should actively adapt to the reshaping of the international tax order led by OECD and gradually increase its voice and influence in the formulation of international tax rules. First, as China's highly digitized enterprises gradually expand their share in overseas markets, unilateral digital tax measures are bound to have a great impact on them. Although the threshold of digital tax is relatively high at present, it is still necessary to pay more attention to the competitive environment of Chinese digital enterprises in the European market, and do enough risk prevention, so as to help Chinese enterprises go global in an all-round way and avoid unfair treatment of Chinese enterprises in the international market. Second, even though China's digital service market is dominated by domestic large Internet enterprises, the loss of economic benefits is relatively small. However, as a capital importing country, it is possible for

non-resident enterprises to hide their income in China by means of digital technology. Therefore, China should actively study the multilateral solution of cooperation and co-governance, formulate perfect international tax agreement, and promote the in-depth cooperation with other countries in the field of tax on the basis of effective protection of China's tax sovereignty. In addition, tax authorities should gradually improve the digital information collection and management capacity, improve the tax source management structure, fill the "tax depression", solve the problem of "island of tax-related information", to carry out effective supervision on scattered and hidden transnational business.

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