More action is needed to achieve fair taxation in the digital economy

Innovative financial services and improved ways of doing business have emerged on the back of the rapidly growing digital economy, a field that has been growing exponentially over the past 10 years.

The digital economy is extremely diverse, driving e-commerce, app stores, online advertising, online payment services, and cloud computing among a wide range of fields.

The level of digitization of various countries has become an important measure of readiness to benefit from the digital economy.

By 2020, 60 billion internet devices are expected to be in use, about five for every person in the world.

In Asia and the Pacific, internet usage is low, with only two in five people using the internet. In Papua New Guinea, only about half the population has access to the internet, while it's almost universal in Malaysia and Singapore.

With broadening internet penetration comes business opportunities, with the number of online shoppers in Viet Nam expected to reach 65% of internet users by 2020.

The World Economic Forum has set up the Networked Readiness Index to measure whether countries are sufficiently prepared to take advantage of the growing digital economy.

The index ranks 139 countries and reflects the diversity of situations across Asia and the Pacific, with Singapore ranked the most "ready" in 2016, and Myanmar ranked 133rd.

Progress could drive innovation and propel growth, raising income levels and improving the quality of life.

New economic technologies could boost gross domestic product in the Association of Southeast Asian Nations by 4% to 12% by 2030.

But to date, most countries that could potentially gain most from these developments are not yet connected and much of the gains remain in the hands of consumers who can afford to access the digital world.

Another challenge is about fair taxation, because the digital economy operates in an environment lacking regulations.

This allows companies to get around domicile-based tax regimes and gain an unfair advantage.

It also puts stable government revenues at risk as more and more activities move from the traditional economy to the new digital economy.

The traditional economy has clear-cut jurisdictional barriers regarding tax but, with no bricks-and-mortar physical location where goods and services are produced, it's hard to identify just where the business entity should pay tax.

It's also difficult for tax authorities to collect value-added tax on cross-border trade.

Policy makers need to adapt and come up with regulations to capture a fair share of tax revenue generated within their jurisdictions.

One major attempt to align tax policy with the new economy was spearheaded by the Organisation for Economic Co-operation and Development. It published an action plan on "base erosion and profit shifting." This plan aims to ensure all businesses are taxed equally to fill the gaps in international tax rules that allow multinational enterprises to legally shift profit to low- or tax-free jurisdictions.

The plan sets up four minimum standards: treaty shopping, country-by-country reporting, dispute resolution, and harmful tax practices.

Implementing the action plan is not easy. There is a lack of data from country-by-country reporting, value-added tax returns, and cross-border transactions, which are needed to understand the broader tax challenges.

A task force on the digital economy, which evaluates the impact of the action plan measures, presents several tax policy options. It proposes changing the rules exempting some digital businesses from having a permanent domicile. It further proposes taxes on certain types of digital transactions and ensuring compliance and collection.

The task force is a platform where countries can share experiences on tax challenges. It's a consensus-based approach but it has its limits.

Discussion continues on how to identify that a company operating in the digital economy has a "significant economic presence."

The OECD recognizes that implementing some recommendations, such as those involving national lawmakers, may take time, and it's an organic process, requiring inputs from as many countries as possible.

Policy makers must adapt to the new context where the digital economy ***is*** the economy.

Fair taxation of the digital economy may be difficult but it's feasible. To achieve it, international cooperation, guided by the action plan framework, is a must.

Countries in Asia and the Pacific must pull together to move reforms, innovate tax structures, and learn from each other's experiences.

As the digital economy is dominated by a few large players, simplifying compliance for them through action plan recommendations could capture 60% to 70% of the market.

This will have a knock-on effect as many small and medium-sized enterprises are using these large platforms to operate, and these big players must be given time to become tax compliant.

All governments should engage with the business sector to help this process, because changing the pillars of the tax system will take time, and the sooner it happens, the sooner developing economies can generate revenue.

This episode was based on research by Wawan Juswanto, senior economist at the Asian Development Bank Institute, and Rebecca Simms, an associate at ADBI when the research was conducted.

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