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**BUSINESS TAXATION IN THE DIGITAL ECONOMY:
EXISTING PROBLEMS AND PERSPECTIVES**

Unquestionably, taxation of e-commerce transactions constitutes an issue of ever-growing importance, given the fact that the Internet spreads rapidly, while online commercial trading increases remarkably. This study attempts a presentation of the implementation problems of a taxation framework in e-commerce characterized by modern state-of-the-art technologies applied in it. Moreover, the theoretical background of proposals and decisions about the issue in question on an international level is drawn, as e-commerce is intricately connected with the globalized market. Furthermore, the current taxation framework pertaining to the operation of e-commerce is presented, derived from European Union directives. In conclusion, proposals are formed towards a more effective implementation of taxation in e-commerce.

Keywords: taxation; internet; e-commerce; digital goods; VAT; permanent establishment.

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**ОПОДАТКУВАННЯ БІЗНЕСУ В ЦИФРОВУ ЕКОНОМІКУ:
ІСНУЮЧІ ПРОБЛЕМИ ТА ПЕРСПЕКТИВИ**

Безумовно, оподаткування транзакцій електронної комерції є питання, який набуває все більшого значення, враховуючи той факт, що Інтернет швидко поширюється, а комерційна онлайн-торгівля значно збільшується. В даному дослідженні зроблена спроба представити проблеми впровадження податкової системи в електронній комерції, яка характеризується сучасними технологіями, застосовуваними в ній. Крім того, теоретична основа пропозицій і рішень з даного питання на міжнародному рівні звертається, оскільки електронна комерція нерозривно пов'язана з глобалізованим ринком. Крім того, представлена діюча податкова система, що відноситься до електронної торгівлі, заснована на директивах Європейського Союзу. На закінчення формуються пропозиції щодо більш ефективного впровадження оподаткування в електронній комерції.

Ключові слова: оподаткування; інтернет; електронна комерція; цифрові товари; ПДВ; постійне представництво.

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**НАЛОГООБЛОЖЕНИЕ БИЗНЕСА В ЦИФРОВОЙ ЭКОНОМИКЕ:
СУЩЕСТВУЮЩИЕ ПРОБЛЕМЫ И ПЕРСПЕКТИВЫ**

Безусловно, налогообложение транзакций электронной коммерции представляет собой вопрос, который приобретает все большее значение, учитывая тот факт, что Интернет быстро распространяется, а коммерческая онлайн-торговля значительно увеличивается. В данном исследовании предпринята попытка представить проблемы внедрения налоговой системы в электронной коммерции, характеризующейся современными технологиями, применяемыми в ней. Кроме того, теоретическая основа предложений и решений по данному вопросу на международном уровне обращается, поскольку электронная коммерция неразрывно связана с глобализированным рынком. Кроме того, представлена действующая

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налоговая система, относящаяся к электронной торговле, основанная на директивах Европейского Союза. В заключение формулируются предложения по более эффективному внедрению налогообложения в электронной коммерции.

Ключевые слова: налогообложение; интернет; электронная коммерция; цифровые товары; НДС; постоянное учреждение.

1. Introduction. Despite the fact that e-commerce is claiming an ever-growing share of conventional trading, the taxation framework governing its proceedings, both nationally and internationally, is characterized by a slow adjustment to the new standards introduced. The particularly hard process of aligning tax legislation with the new trading morals of e-commerce is in direct conjunction with the very nature of the Internet itself. Taxation of e-commerce is an issue on which many and often contradictory views have been expressed worldwide over the last twenty years, as is recorded in international bibliography. Nevertheless, up to date, applying tax legislation to e-commerce presents many problems. Regarding tax legislation governing e-commerce, the European Union has been a pioneer on an international level, having focused its efforts on indirect taxation of VAT.

2. A brief presentation of e-commerce. The term e-commerce is used to describe the whole scope of business practices which combine modern technologies and methods, with a view to materialization of commercial transactions via electronic means. E-commerce, in terms of the materialization of transactions, is distinguished in direct e-commerce, in which there is electronic ordering and delivery of digital goods and services, and indirect e-commerce, in which the delivery of material goods is realized with the traditional methods (Doukides et al, 1998). The former term is addressed in the argument presented hereafter, on the grounds of the new standards it introduces to taxation.

What is more, the following categories are drawn concerning the participating bodies:

a) inter-business prototype (Business to Business, or B2B), which includes communication and transactions undertaken between businesses,

b) communication prototype between businesses and individual consumers (Business to Consumer 2C), which includes communication and transactions undertaken between businesses and consumers,

c) communication prototype between users (User to User), which deals with the communication and transactions undertaken between end users (Lee U, 2004).

Through e-commerce, consumers (individuals and businesses) have more opportunities to compare prices and purchase products and services from distant taxation domains at lower rates of consumer tax (Lackarite, 2009). Moreover, due to the absence of the profit margin of the conventional go-betweens (delivery agencies, brokers, sales representatives, etc.), prices in e-commerce can be cheaper, resulting in a smaller base of consumer tax (Lighthart, 2004). Therefore, the digitalization of the economy is considered as a key driver of innovation, economic growth and societal change, and is a major challenge for the international tax system (Olbert and Spengel, 2017).

3. Problems of applying the taxation system to e-commerce. The economy has evolved at a fast pace with digital business models expected to arise quickly. However, the international tax system seems outdated before that new reality. Hence, its reform is now an urgent task should we ensure a fair and efficient game on a playing field

where digital business meets traditional economy (Nhung and Marcel, 2019). Concepts like permanent establishment, sale points, product and income classification that using in taxation process have been remained inadequate (Yapar et al, 2015).

A number of complex problems characterizes the outlook on the matter in question from the point of view of taxation. More specifically:

- The globalized Internet market, accessible from almost anywhere, clashes with national tax legislations and tax administrations.

- The digital nature of goods marketed via e-commerce has as a result that the taxation framework determining proceedings in conventional trade is not capable of dealing with the new reality.

- On the part of tax administrations, identifying the conducted transactions, the contracting parties, as well as their geographical positions is extremely difficult (Theocharopoulou, 2007).

- The presence of enterprising companies in the area of e-commerce could be associated with a lack of permanent establishment (PE), and locating them can be particularly difficult, taking also into account the ease of transferring their activity to another hosting provider. In fact, the concept of permanent establishment of a business is particularly vague in direct e-commerce, as websites of internet businesses can be hosted in servers located in other countries, rendering them difficult to trace.

- The possibility of double or multiple taxation from different countries exists, which goes against the conventions of avoidance of double taxation signed between countries. Dealing with royalties in terms of taxation is also difficult to apply.

- The risk of worldwide tax base erosion is imminent, given that businesses can transfer their activities to tax domains where low taxation is enforced, thus avoiding tax control (Pinto, 2005). As a matter of fact, e-commerce is a field in which transfer pricing can easily be applied.

- In the light of the aforementioned observations, as well as of the new forms of payment methods online (pre-paid cards, pre-paid electronic payment software), tax audit of internet businesses and transactions executed by them is rendered extremely difficult.

Cross-border trade in both goods and services (which include for VAT purposes digital downloads) creates challenges for VAT systems, particularly where such goods and services are acquired by private consumers from suppliers abroad. The digital economy magnifies these challenges, as the evolution of technology has dramatically increased the capability of private consumers to shop online and the capability of businesses to sell to consumers around the world without the need to be present physically or otherwise in the consumer's country. This often results in no VAT being levied at all on these flows, with adverse effects on countries' VAT revenues and on the level playing field between resident and non-resident vendors. The main tax challenges related to VAT in the digital economy relate to (i) imports of low value parcels from online sales which are treated as VAT-exempt in many jurisdictions, and (ii) the strong growth in the trade of services, particularly sales to private consumers, on which often no or an inappropriately low amount of VAT is levied due to the complexity of enforcing VAT-payment on such services (OECD, 2014).

Also, tax laws in general rely heavily on the categorization of income to determine the rate and means of taxation. With digitalization, it is difficult to clearly distinguish some types of income, especially among royalties, service fees, and business profits (Terada-Hagiwara et al, 2019).

4. Proposals about e-commerce taxation on an international level. Taxation of online transactions has become probably the most controversial issue in e-commerce. The complexity of the issue of e-commerce taxation is reflected on proposals presented internationally. Referring to literature worldwide, it is found that fundamental proposals have been submitted by the European Union, the government of the U.S.A., the Organization of Economic Cooperation and Development (OECD) and the World Trade Organization (WTO). The problematic on the issue in question, still ongoing, actually began in 1996, and brought about suggestions which were in some cases in conflict with each other. The principal ones were the following:

The proposal of a committee put together by the European Union in 1996 called for imposing bit tax, a special tax applied on the basis of the time spent online, and the distance between the connecting parties. This proposal was not adopted, among other things because it could hinder the growth of the Internet. What is more, it could reduce the use of the Internet, as the tax would be imposed even on free use (Fortsakis, 2005). The disadvantages of this particular proposal included also the fact that bit tax did not take into account the value of the goods taxed (Lighthart, 2004).

A diametrically opposite proposal dominated in 1997 in the U.S.A., according to which a worldwide free Internet zone would be created, free of tax conditions for direct e-commerce. In October 1998, the American Congress established the Internet Tax Freedom Act (ITFA). However, there is a strong controversy in the U.S.A. between those in favour of imposing tax on the Internet, on the grounds of loss of tax income, and those in opposition to Internet taxation, as taxes would increase the cost for the consumer and thus restrict the development of the use of the Internet and of e-commerce (Griffin et al, 2008). In fact, according to Rothenburg (2006) many support that as e-commerce sales are low, they should not be taxed, while others support full tax compliance. There is yet a third outlook according to which the tax on the sales and the use of such transactions should be determined by a single rate nationwide.

The OECD on its part acknowledges that Internet taxation is a problem that needs to be addressed collectively on the level of tax administrations of its Member-States requiring coordinated and multi-faceted actions. During the first official OECD Ministerial Conference on this particular issue in Ottawa, Canada, in 1998, the framework of tax principles that should govern e-commerce was set. These principles were:

a. **Neutrality.** According to this principle, taxation should aim for neutrality and justice between conventional and electronic commerce and between different forms of e-commerce.

b. **Efficiency.** Compliance costs for consumers and administrative expenses should be minimized as much as possible.

c. **Certainty and simplicity.** Tax rules should be clear and simple so that they are understood by all taxpayers.

d. **Effectiveness and justice.** Taxation should impose the right tax rate at the right time, and the possibility of tax-evasion and tax-avoidance should be minimized.

e. **Flexibility.** Tax systems should be flexible and dynamic so as to keep up with the technological and commercial developments (OECD 1998).

The European Union, in continuous negotiations with the U.S.A. as well as OECD and WTO, came to compose the Announcement COM (1998) 374 of the

Commission of the European Communities, which aimed at setting guidelines on indirect taxation value added tax (VAT) in e-commerce. These guidelines were:

a. Imposing no new taxes. In the sector of indirect taxation all relevant efforts should focus on adapting existing VAT rules in the development of e-commerce.

b. Electronic transmissions are considered services. An action by which a product is put at the buyer's disposal in a digital form via an electronic network should be considered, in the interests of VAT, rendering of a service.

c. Ensuring neutrality. The VAT system should ensure that services rendered electronically within the E.U. are taxed within the E.U., irrespective of origin, and that services rendered by companies from the E.U. outside the E.U. are not subject to VAT within the E.U.

d. Facilitating observance of obligations. Taxation procedures should be designed which are fully compatible with the expected growth of trading practices in e-commerce.

e. Ensuring control and enforcement. The tax system and the means of control it provides for should ensure that the tax is truly enforced in electronic services within the E.U., both to companies and individuals.

f. Facilitating tax management. Pricing and keeping of accounting forms in electronic form should be made possible and tax administrations should allow the business bodies which are active in the area of e-commerce the possibility to carry out their tax obligations in electronic form.

In the course of the base erosion and profit shifting (BEPS) project, the OECD focused on tax challenges of the digital economy. The February 2013 report *Addressing Base Erosion and Profit Shifting* identifies a number of coordinated strategies associated with BEPS in the context of direct taxation, which can often be broken down into four elements:

- Minimization of taxation in the market country by avoiding a taxable presence, or in the case of a taxable presence, either by shifting gross profits via trading structures or by reducing net profit by maximizing deductions at the level of the payer;

- Low or no withholding tax at source;

- Low or no taxation at the level of the recipient (which can be achieved via low-tax jurisdictions, preferential regimes, or hybrid mismatch arrangements) with entitlement to substantial no routine profits often built-up via intra-group arrangements; and

- No current taxation of the low-tax profits at the level of the ultimate parent (OECD, 2014).

The Council of the EU in 2017, adopted new rules making it easier for online businesses to comply with VAT obligations. According to these rules, the main features of the new system provide that, VAT will be paid in the member state of the consumer, ensuring a fairer distribution of tax revenues amongst member states and online platforms will be liable for collecting VAT on the distance sales that they facilitate.

The new rules set out the following timeline:

- introduction by 2019 of simplification measures for intra-EU sales of electronic services;

- Extension by 2021 of the one-stop shop to distance sales of goods, both intra-EU and from third countries, as well as the elimination of the VAT exemption for small consignments.

Therefore, the spread of the digital economy creates challenges for international taxation as well as domestic tax revenue mobilization. As taxes are the main sources of revenue for the government to fund its various public services and projects, tax authorities must learn to adjust their capability to catch up with the fast change of digital economy activities (Juswanto and Simms, 2017). Capital moves fluidly and at lightning speed but these dramatic efficiencies of the digital economy comprehensively disrupt taxing patterns. National economies are being forced to cooperate, to shore up the revenue leaks and to pursue some sort of common ground and global parity among tax systems (Corkery et al, 2013). The country's next steps should include continued participation in the International Taxation Forum, adoption of unilateral measures, improvement of its tax registration system to address untaxed consumer-to-consumer transactions, and strengthening of its tax administration capacity (Terada-Hagiwara et al, 2019).

5. Conclusions – Suggestions. From the presentation of the contemporary taxation framework which focuses on indirect taxation it is concluded that crucial issues of the problematic developed above require further examination with the aim to adjust classic tax principles (direct and indirect) to the new technological standards brought about by the digital economy of cyberspace. This adjustment will, of course, be the result of international cooperation and consent, given the globalized nature of e-commerce. At the basis of this cooperation, software could be developed which, after establishing electronically the permanent establishment of the parties participating in the electronic transactions, would withhold the corresponding indirect taxes and render them electronically to the tax domains entitled to collect them. The WTO could, in fact, play a more significant role by determining a framework of international negotiations.

Tax administrations, besides adopting OECD and EU guidelines and aligning tax law, should also intensify efforts regarding tax control of online transactions and businesses, by using advanced electronic control tools, and scientific methods of Information and Communication Technologies, as well as exploiting international experience. Also of significant contribution would be the training of the tax control personnel by executives from tax administrations of EU Member-States, or from other states who have gained more extensive experience in e-commerce taxation.

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