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Digital Taxation in the Global Economy

The global economy is rapidly changing and especially when considering the rapid growth of digital products and services. As a result, the taxation regarding these industries continues to change as well. Political and economical debates have been underway on exactly what and how to tax these sectors.

A key topic of conversation is the difference between physical business operations and virtual operations. Another ongoing issue is the speed at which technology evolves. Typically, the evolution of the industry outpaces the tax and regulation policies designed for them.

What is Digital Taxation?

According to the Tax Foundation, “digital taxes include policies that specifically target businesses which provide products or services through digital means using a special tax rate or tax base.” When Value-added Tax should be applied to digital services or identifying when a digital company has nexus even without a physical presence are examples of the complexity.

Digital taxation can be discussed in light of five categories including consumption taxes, service taxes, business tax preference, permanent establishment, and gross-based withholding taxes.

1. Consumption. Consumption taxes are Value-added Taxes (VAT) on the sale of goods or services. This taxation has increasingly been applied to digital products and services.

2. Digital Service Taxes. Digital service taxes are taxes on revenue derived from certain types of digital services and products. In some countries, the taxation is applied based on the number of users.

Digital Taxation (cont)...

3. Digital Business Preferences. Business preferences have been established focusing on the digital industry to help offset the growing tax base. For example, specific credits for research and development and other unique expenses only allowed for digital businesses.

4. Digital Permanent Establishment. An area of taxation that seeks additional clarity is what constitutes permanent establishment in certain states and countries when the footprint may only be digital. This establishment typically considers factors including the frequency of business, volume of revenue and number of users in the jurisdiction.

5. Gross-based Digital Withholding Taxes. In some countries, corporate taxes or consumption taxes are bypassed in favor of gross-based withholding taxes for digital products and service revenue.

Digital Taxation Issues

As mentioned, there are several areas of complexity when discussing the taxation of digital revenue. While many traditional organizations have revenue from digital products or divisions, many companies have no traditional income and produce only digital revenue.

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When discussing the global economy, many U.S. based software companies for example, produce millions in revenue in other countries without any physical presence.

Companies such as Amazon, Salesforce, Facebook, Alibaba and Google have all created new world taxation dilemmas that politicians and taxing authorities have to sought to fix. There are billions of dollars of revenue at stake and jurisdictions are eager to get their hand on the respective tax revenue.

In some cases, new tax policies are derived from scratch aimed specifically at certain services. Examples include cloud hosting, social media companies, e-commerce, and web-based service platforms. In other situations, existing tax code and procedures are adjusted to coincide with the changing digital landscape.

An updated view regarding consumption taxes is also underway. The goal is to develop a modern understanding of what it means to “consume” a product or service in the digital age. Also, as previously mentioned, where this consumption takes place is considered in light of the fact that most of it is over the internet.



Because many of the largest businesses operate globally, international cooperation presents challenges when establishing a set of taxing guidelines. Without multi-national agreements, the likelihood of conflicting information and double taxation is high.

Value Creation

The historical view of global taxation revolves around the concept of value creation. In other words, wherever the most value was created for the product is where it should be taxed. This value created taxation method is being reconsidered as proponents of digital taxation argue that additional factors should be considered including the value created by users and product reviewers.

In addition, many digital companies provide the service or platform free of charge. Social media platforms offer their platform for free in exchange for data collection that allows more effective targeted ads by other companies. This means that much of the value of the platform is derived by the end user in countries all around the world.

Another example of a value creation dilemma is observed when considering population and consumption rates. Asia accounts for nearly one-third of all internet activity while only creating roughly 20% of the value created services and products. On the other hand, it is believed that North America accounts for only around 10% of internet activity but produces nearly 40% of its product and service value.

These factors have led to increased discussions regarding unilateralism and multi-lateralism. The growing consensus is that businesses should be taxed based on where their product is consumed or their user lives. This produces political challenges at the global scales depending on the end result for each country.

For example, the United States will not be too eager to give up much of its tax revenue to a foreign country when the software is completely developed in California. On the other hand, smaller countries with a small digital production footprint would more than welcome the influx of tax revenue based on the user consumption of these products by their citizens.

One of the primary councils considering these measures is the Organization for Economic Co-operation and Development (OECD). More than 130 countries have agreed to join in the discussion and seek to resolve the growing complexity of these tax challenges. All parties involved are aware of the challenges and aim to avoid the ramifications of conflicting tax policies, trade wars or worse.

