Hello everyone, my name is Jaffar Al-Rikabi, senior economist of the World Bank. In for this section I will be briefly discussing some of the tax policy issues relevant for the data economy and the future of taxation as a whole.

Now, my way of introduction, let's start with the basic fact about the global economy today. If you think of all the factories, the office buildings, the merchandise, the cars and all the other physical assets owned by all the companies in the SMP 500 - thanks to globalization and digitalization, the data revolution all these physical assets were just under 20% of the SMPs 500 market capitalization, which grew to over US$31.6 billion by the end of 2020. So, what about the more than 80% left. Well, much of just that comes from things that we cannot easily see or count or value - Data, the algorithms, the brands and other intangible assets.

We’ve learned in earlier sections of the course, how data and intangible assets have transformed competition, trade and the economy as a whole. The impact on taxation has been equally tremendous. This is because tax rules that are operated for the best part of the last one hundred or so years, elements such as the definition of permanent establishment to assign profit taxing rights or elements such as the arm's length principle - these tend to emphasize the tangible features for businesses, including for example, the location of people's assets, physical assets that is. In contrast, data driven value chains with their bases in intangible assets emerge as difficult for tax administrators to map, to track, and this facilitates aggressive tax avoidance by multinational enterprises or MNEs.

The result - large MNEs benefiting from aggressive tax planning schemes. These are schemes enabling them to shift profits to jurisdictions with low or zero tax rates have paid very little taxation. This has fostered a sense that the tax system is unfair, undermining public morale in the tax system as a whole and prompting protest movements demanding international tax reform all over the world.

Thankfully governments are reacting, supporting by international organizations such as the OECD, IMF and the World Bank by academics and other civil society organizations, governments are coming together in fora such as the OECD G 20 inclusive framework on base erosion and profit shifting or BEPS to negotiate reforms of the international tax system.

Two key taxes are focused for this discussion and for the WDR. One is the value added tax or VAT, a particularly important type of tax for developing economies. And the second is profit tax or corporate income tax which is the focus of international taxation agreements on direct taxation rights.

Let’s start with the VAT. Progress has been made in adapting the VAT for the modern economy. A key principle is that taxation rights under VAT are to be allocated to the jurisdiction where the final consumption occurs.
So, think of a consumer living in London who uses a digital platform to purchase a piece of fashionable clothing from a Paris based merchant. Well, the VAT in this case would go to the British treasury because the consumer buying this item of clothing is based in London. This is the sort of principle that what we are talking about here.

But, unfortunately despite agreement on these boards’ principles lacking administrative capabilities, in low- and middle-income countries have prevented these approaches from being fully implemented. So, what's needed on the administrative side - a number of measures. Let me give you a few for example. We would need foreign suppliers to register an account for the tax due on sales to consumers in their territories. For example, you would need some kind of online interface, a portal so that those businesses like that Paris-based merchant could register, could file and could pay the VAT that they have collected from consumers to the British treasury.

We would need other measures in place. For example investing in extensive use of third party data and combining that with tax and customs data collected by the government. And this is for compliance management to ensure all the businesses that need to be registered are indeed registered and filling and paying the appropriate amount.

What sort of third-party data are we talking about here - For example, internet service providers data, Data from digital platforms on transactions, banking data, credit card company data, business registries data. All of this could come to force and be useful but only if tax authorities have the right technology in place to leverage these data. And as discussed in earlier parts of this course, naturally safeguards are going to be very very important to ensure data security and privacy are maintained.

So, what is the potential impact of these changes to the VAT.

In the European Union more than 3.3 billion US dollars has been raised in tax revenues through general application of these rules. Now, think about economies in Asia, Sub Saharan Africa. In the context of Covid-19 and even earlier there has been rapid growth of e-commerce, online media and other data driven businesses. This means that the VAT potential on this sector is both substantial and increasing rapidly over time. Now, beyond raising more revenue, these reforms are critical to ensure a level tax playing field between digital and non-digital businesses and between foreign and domestic businesses.

We want to all face similar levels of taxation so that the overall system is equitable and back. So, this is why reform of the VAT matters. What about the second type of taxation? Direct taxes on corporate profits. Let’s review briefly some key pressure points. Firstly, there is the point that globalization and technology have facilitated the decoupling between physical presence and economic presence. Second, there is the fact, as mentioned in the introduction of this course, that intangible assets have grown in value and this makes implementing the arm's length principle very tricky, exacerbating profit shifting.

And third, is the fact the value generated by customers that is the users. Their data have become critical to driving the expansion of many digital service providers. And so a good case can be made as to countries trying to capture some of this value. Today there is a major reform proposal of direct taxes there is being negotiated by countries and is described as the two-pillar solution.

Let’s briefly discuss this proposal. In pillar one of this proposal, a new taxing right is established with a proposal to reallocate through a formula part of the so-called residual profits earned by MNEs to
markets or destination countries regardless of physical presence. This is an important new taxing right representing a fundamental shift from existing norms.

So, what are the scope of these proposed rules. The MNEs being discussed would need a global turnover above EURO 20 billion and profitability above 10% defined as profits pretax above or divided by revenues. This is what we mean by residual profits, any profits above this amounts.

In addition, the negotiators have excluded the extractive sector and the regulated financial services sector. The proposal goes on to say that market countries for whom in scope MNEs have sales of above 1 million EUROS in revenue or for smaller GDP countries above 2,50,000 EUROS they would have a share of these MNEs tax liability. And between 20 to 30% of the residual profit, defined as profit in excess of this 10% on revenue would be reallocated to the relevant market jurisdictions using a formula that is yet to be agreed upon. This is the core part of this new proposal.

In pillar 2, a second part of this proposal essentially what is a strive for is a minimum effective tax rate on corporates, all over the world that has been set at 15%. I won't go into the technical details of the second pillar, but the ambition is clearly to try to tackle profit shifting and reduce tax competition and the attraction of low-tax jurisdictions.

What are the possible impacts of this agreed upon proposal? Firstly, worthwhile saying that 132 member jurisdictions thus far have signed up to this proposal as of 9 July 2021. So, it seems that many countries like it. Now, some technical details need to be agreed and so it's early days to really judge the possible impacts.

But one key principle has to be that the rules that are agreed upon needs to be able to be implemented by low-capacity authorities. So simple rules will be powerful because it means countries worldwide whether higher income or lower income will be able to adopt them and effectively implement.

Interesting that some early research by M. Devereux and M. Simmler of the Oxford University, Center business taxation share some really quiet powerful insights on what the potential impact of this proposal could be. They find the 78 of the world's 500 largest companies would be affected by this proposal with a total allocation estimated at US dollar 87 billion. Around 64% of this amount would be by US headquartered companies and around 45% of this amount will be generated by technology companies.

Scoping decisions, these scholars find matter, because for example, if you want to include the regulated financial services sector, you would approximately double 87 billion dollars of tax amount that could be generated by this reform proposal.

The definition of profits similarly would be important. So, for example in the European Union, if you were instead to define profits as - above 10% of return on equity, you would double the amount of European firms that would be included in this reform as opposed to the above 10% on revenue.

So overall, this early research suggests this reform is meaningful and if implemented would likely have a substantial impact on some countries and some sectors but that it could probably be significantly broadened through changes to the definitions and scope of these new rules.
I hope this gives you a sense of why reforms of the VAT and of direct taxation are important for the data driven economy. If you have found this interesting, please read more by downloading our reports and feel free to send me any questions – my email posted here.

Thank you very much for listening.