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TAXATION IN ERA OF GLOBALIZATION AND DIGITALIZATION

Issues and Challenges on National Tax Sovereignty

-abstract-

For many years globalization and digitalization resulted in the internationalization of the world economy creating a number of possibilities for taxpayers, mainly legal entities. In such circumstances, companies have managed to incorporate a network of permanent establishments worldwide, while countries have benefited from the transfer of goods, services, assets, human capital, knowledge and technological innovations.

For more than two decades this was perceived as a "win-win" situation, until multinational companies have become more inventive in finding methods to maximize profits, on one hand, and minimize taxes, on the other hand. Therefore, globalization and digitalization, differences in tax systems and territorial limitation of national tax sovereignty, have reshaped the international tax landscape. As a result, countries have been facing disrupted market fair play rules, the unreasonable competitive advantage of certain companies, distortion of tax systems and, perhaps most importantly, significant tax revenue losses.

International organizations, such as OECD, EU and G20, have recognized the necessity for a systematic approach to efficiently fight tax avoidance, aggressive tax planning, transfer pricing and thin capitalization, to improve the coherence of international tax rules and ensure a more transparent tax environment. Currently, more than 135 tax jurisdictions are collaborating, by implementing the proposed measures and minimum standards in their national tax legislation, to at least reduce to the lowest possible level all the strategies that represent harmful tax practices, base erosion, and profit shifting to countries with more favourable tax systems, tax treaty abuse, and exploiting gaps and mismatches in tax rules to avoid paying taxes in the country where the economic activity is performed and where the profit is generated.

Implementation and transplantation of such actions into the national legislation require political will and governmental determination to be a serious partner in the international combat against tax evasion and tax avoidance. As a consequence, this seriously challenges and affects the national tax sovereignty and states` rights to tax.

Key words: national tax sovereign, international taxation, tax evasion, tax avoidance.

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"Tax policy is not only the expression of national sovereignty but it is at the core of this sovereignty, and each county is free to devise its tax system in the way it considers most appropriate".
OECD (2013), *Addressing Base Erosion and Profit Shifting*, OECD Publishing, 28.

I. INTRODUCTION

For a long period of time tax policy was a purely national affair. All taxes were introduced and tax policy decisions were made in a context of clearly separated national economies. Trade barriers restricted international trade, and the free movement of persons, goods, services and capital was limited. There were no cases of international spillover because all effects were bounded to the national market. This was, also, a period when countries had the possibility and autonomy to develop their tax systems in specifically national ways. In such an environment, the tax state had a notably "good twentieth century" (Hood, 2003).

This landscape has drastically changed in the last 50 years. There is no doubt that the key feature of the 21st century is the intensive process of globalization. The globalization is a multifaceted phenomenon that is often viewed as the increasing internationalization of the market for goods and services, the means of production, financial systems, competition, corporations, technology and industries. In the very beginning, it was perceived as the best way to bring the much-needed influx of jobs, greater supply and diversity of affordable consumer goods, access to cutting-edge technology, boosts in income, and the path to sustainable growth. On the other hand, these developments have important implications for taxation and the tax state was put on an entirely new basis. Several tax challenges have arisen as a result of the increased mobility of people, goods, services and capital. The openness of the national economy has enabled ease of moving economic activity and shifting profits across different tax jurisdictions as corporations and individuals take advantage of mismatches and differences in tax regulatory frameworks.

Even though nowadays countries are functioning in a globalized world, taxation remains a central element of national policy. It is the main source of revenue mobilization to finance public service delivery and has an important redistribution role. In addition to these traditional tasks in the domestic economy, tax policy takes on an expanded role in the context of globalization. Under these circumstances, national fiscal policy is created and implemented in order to achieve two important objectives. The first objective is to improve the competitiveness of national enterprises compared to foreign companies and secondly, to attract foreign capital and save while retaining domestic capital in the local economy.

These developments put pressure on national tax systems that must strike a balance in meeting the dual objective of mobilizing government revenue on the one hand and facilitating trade, retaining and attracting investment capital on the other hand. Digitalization and the proliferation of tax havens, secrecy jurisdictions, and offshore financial centres have made matters even more complicated.

Today, the tax sovereignty seems to be guarded against a selfish position, aimed at keeping the autonomy of governments to decide their tax policy, while competing in the free market. Competition is not harmful in itself; it has shown genuine results and long-term benefits. Thus, some forms of aligning the tax policies of each country are promoted by international organizations, in regard to more efficient combat against the tax avoidance, aggressive tax planning, exploiting tax mismatches and shifting profits toward more preferable tax regimes. The time has just confirmed that in terms of globalization, numerous cross-border transactions and a worldwide network of permanent establishments, these tax problems could not be solved unilaterally. According to a rather widespread view among both public opinion and academia, international responses to these global harms threaten the sovereignty of national states in fashioning of one state's jurisdiction to tax.

There is an urgent need for tax cooperation, but are the countries prepared to curtail their capacity to pursue autonomous tax policies at home? While promoting cooperation, these initiatives make every effort to protect state sovereignty on tax matters. Walking a very fine line, they are striving to design a binding multilateral regime where states will not have to give up their alleged sovereign control over taxes. In addition, they try to preserve the position of states as independent actors that are simply negotiating for a deal that serves their mutual interests, rather than surrendering their sovereignty to a supranational body.

Though in the reality of tax competition, it is difficult to emphasise tax sovereignty as most, if not all, states are not in a position to put in action their tax policies autonomously and independently of other countries. The fact is that at least that states can do in today's international tax climate is to opt among painful alternatives.

The main aim of this paper is to analyze the effects of globalization and digitalization, as the main characteristics of the modern world, on the national tax sovereignty. The key question is: *whether and to what extent the new problems caused by globalization have reshaped the states` right to tax*? In the first chapter, the author gives a brief summary of the concept of tax sovereignty. The next Chapter analyses how the tax autonomy was challenged by the process of globalization and the following Chapter investigate the tax policy reactions to these issues. The paper concludes with final remarks of the future of the tax state in the global economic system.

II. THE TAX SOVEREIGNTY BACKDROP

There is no single definition for the term "sovereignty", but the literature points out three core elements that one sovereign country possesses: territory, people, and a government. In possessing these elements, a sovereign state should display internal control and supremacy, along with external independence from other states. The sovereign is also a duty and an obligation to protect and promote the welfare of its citizens. Sovereign responsibilities now accompany those sovereign rights.

Tax policy is traditionally viewed as the domain of national sovereigns. From the traditional perspective, a country has tax sovereignty if it is entrusted with exclusive tax legislative powers, aiming to maximize welfare efficiency and justly (re)distribute it (Pendovska et al., 2021). Such country has a full supremacy to create and implement its own national tax system, as a set of rules, regulations, and procedures that (i) defines what events trigger tax liability (tax bases and rates), (ii) specifies who or what entity must pay that tax and when, and (iii) details procedures for ensuring compliance, including information-reporting requirements, and the consequences (including penalties) of not remitting the legal liability in a timely fashion (enforcement rules) (Boix, 2011, p.262). Given these fundamentals, there are many ways and features that individualize tax systems, even in the rare situation when two or many of them are considered similar.

In terms of globalization, this is significantly changed. At the moment, on an international level, there are 200 or more tax sovereigns that compete with one another for investments, residents, and tax revenues. As a result, competition has transformed the world of sovereign-controlled tax policies.

III. THE ERA OF GLOBALIZATION

Globalization is a complex phenomenon, which encompasses a great variety of tendencies and trends in the economic, social and cultural spheres. It has a multidimensional character and as a consequence, does not have an exclusive definition. However, it may be described as increasing and intensified flows between countries of goods, services, capital, ideas, information and people, which produce cross-border integration of a number of economic, social and cultural activities.

Thanks to technological innovations and greater economic liberalization, entrepreneurs, especially multinational corporations, have taken full advantage of more open markets to spread business activities all over the world. The opening up of economic opportunities allows the movement of foreign capital, technology and management, largely from transnational corporations. Although multinational companies are not new economic entities, globalization has a major impact on the way they operate around the world and their increased level of economic power.

Globalization, and more in particular economic integration, presents both opportunities and costs. For this reason, it should not be demonized nor sanctified, nor should it be used as an excuse for the major problems that are affecting the world today (Bastians et al., 2018, p.13). Greater economic openness, foreign direct investment, and transfer of technologies offer potential opportunities for economic growth. Greater openness may even encourage governments to undertake reforms to improve the legal and economic institutions, as well as to adopt policies that favour greater competition. Many experts, however, have claimed that globalization reduces the capacity of the state to provide social services as it leads to a decrease in the level of taxation.

Globalization has prompted a re-examination of ideas of distributive justice and its traditional focus almost exclusively on the national sphere (Dietch et al., 2014, p.2). For the first time, states are facing the necessity to abandon the stereotyped concept of a sovereign state as independent from all external forces and in complete control domestically. So, this only raises the dilemma a propos the limits of a state`s tax sovereignty. Just because the global system operates with sovereign states as dominant players and just because the states set tax policy and collect and use the resulting revenue, it is critical never to lose sight of the fact that sovereignty is about the international relationships among states (Ring, 2009, p.557).

a. Tax Sovereignty in Globalized Economy

Sovereignty is not just a legal concept, but also a characteristic of a state`s power that is undergoing important transformations worldwide. Opposite to the conventional view that the concept of sovereignty has a timeless or universal connotation, more studies have focused on the changing meanings of this concept in a variety of historical and political contexts (Tofan, 2020, p.6-7). As previously mentioned, from a fiscal point of view, the sovereign state can rule the tax system, establish tax liabilities, to collect taxes, apply a sanction when fiscal discipline is not respected and even to pardon certain fiscal liabilities, using amnesty acts. The traditional architecture of the tax state was based on the assumption that all taxable events have a clearly identifiable place in space: either they fall within a national tax jurisdiction, and are therefore liable to national tax, or they fall within the jurisdiction of some other state, and are liable to tax there (Tanzi 1995).

In recent decades and especially since the 1980s, some important events have been changing the economic landscape. Additionally, these events have potentially significant implications for tax systems worldwide. The most essential among these developments is the opening of economies accompanied by a phenomenal boost in cross-border capital movements daily and the increased importance of multinational companies both in the financing of direct investment or in promoting trade among parts of the same enterprises located in different countries.

The heterogeneity of national tax systems was not any concern as long as the fences separating national markets were up. When these fences began to come down, differences in national tax regulations started to put additional pressure on politicians causing them headaches. The lifting of trade barriers, liberalization of world capital markets, and swift technological progress, especially in the fields of information technology, transportation and telecommunications, have enabled the rise of so-called "fiscal termites" (Genschel, 2001, p.5-6). Like biological termites, these termites are weakening the foundations of current tax systems. They are making it progressively more difficult for countries to maintain high levels of taxation. The first of these termites is Electronic Commerce. A second termite is Electronic Money (credit cards, cash machines, and other cards). A third important termite originates in transactions that take place between different parts of the same multinational enterprises i.e., Intra-Company Transactions. And last, but not least termite is the existence and the rapid growth of offshore financial centres and tax havens. Moreover, in a globalized economy governments worry about three tax problems: tax competition, tax evasion and avoidance, and the transnationalisation of the tax base. The twin problems of tax competition and tax avoidance/evasion are exacerbated by a third one: the transnationalisation of the tax base (Genschel, 2005, p.15-20).

When states compete with each other for attracting investments, residents and permanent establishments, they have no longer had the liberty to design their policies in a vacuum. The competition gives taxpayers a choice, to shift their capital, their profit, their residency or their entire business activity to another (usually) more favourable tax jurisdiction. By providing taxpayers with a viable alternative, tax competition makes the decision-making process even more difficult and challenging. Therefore, sovereign states, previously defined by their powers and control over their citizenry and territory, find themselves in an unknown position where the tax sovereignty is considerably limited. The constant battle for capital and residents, along with tax avoidance, tax arbitrage and tax evasion, all seriously threaten the abilities of states to tax.

Thus, in the current competitive international tax regime, tax sovereignty is in danger. The independence of states in collecting taxes and their power to sustain the basic goals of income taxation are undermined (Dagan, 2017, p.37-42). Because of these developments, a country's potential tax base is now no longer strictly limited by that country's territory, but, in some sense, it has extended to include parts of the rest of the world.

b. Issues and Perspectives on State`s Right to Tax

In the epoch of globalization, digitalization and internationalization of the economy, taxation evolved from a national, purely domestic regulatory prerogative to a very demanding and intensely argued topic among governments, supranational organizations and international institutions. The ubiquity of using state sovereign right to rule taxation and the dysfunctions of international taxation create the opportunity for avoiding the tax mandatory liability (Stiglitz, 2003, p.20). Although the perception of independence of sovereign authorities in designing tax rules has indisputable support among many policymakers and scholars, multilateral cooperation is widely perceived as a reasonable and justified attempt to retain or regain the state's power to tax (Ndikumana, 2014, p.13). The subject is sensitive as taxation meets two divergent interests: paying less taxes and obtaining higher revenues to the state budget.

In recent years, states have made several efforts to cooperate in the fight against harmful tax competition, aggressive tax planning, base erosion and profit shifting and tax treaty abuse. According to the OECD, one important reason to worry about tax competition is that it "poses a threat in terms of tax sovereignty and of tax revenue" (OECD 2013b, p. 47). More specifically, it may hamper the ability to raise sufficient revenue and secure the redistributive goals desired by the countries' population (OECD 1998, p. 14). Therefore, one important aim of the BEPS project is to support 'the effective fiscal sovereignty of countries over the design of their tax systems' (OECD 2014, p. 14). The OECD suggests that fiscal self-determination could be secured by the implementation of the principle of economic allegiance. According to this principle, the jurisdiction to tax should be distributed in accordance with where "the true economic interests of the taxpayers are found" (McCarthy et al., 2008, p.17-18). Individuals and corporations have economic interests where they earn or gain income or/and capital, or where they perform economic activities. The principle is reflected in the BEPS project, which aims to "better align rights to tax with economic activity" (OECD 2013b, p. 11, cf. OECD 2013a, p. 18) by ensuring that corporations do not shift accounting profits to low tax jurisdictions and so artificially separate the profit from the economic activities that generated it (Van Apeldoorn, 2018, p. 480-485).

The fact that cooperation is required on many levels as a consequence of the complexities and transnational nature of contemporary international tax problems has led a number of scholars to foresee the beginning of the end of national tax sovereignty. Some argue that the modern State may only adjust to globalization, but not have an active role in it. Some believe that as time passes the State will become outdated. Despite the many concerns about the loss or the limitation of the state`s autonomous right to create and implement national tax policy, the State remains the key factor in the domestic as well as international arenas (Neshovska Kjoseva, 2020). The popular assumption that the emergence of the global economy, increasing levels of cross-border transactions and the influence of multinational companies, turns the nation-State into a survivor is wrong. In the international arena, closer cooperation and intensive action among States represent an exercise of State sovereignty (Maksimovska Stojkova, et al.2019). Such cooperation and actions do not necessarily weaken States; rather, they can strengthen them by creating a more stable international tax environment (Bertucci et al. 2001, p.5).

IV. FINAL REMARKS AND RECOMMENDATIONS

It is government and government alone that has the duty to provide public goods and services and to redistribute the income among rich and poor. As a result, taxation has been at the very core of the sovereign state since ancient times. There is no doubt that taxation will remain the main revenue source of the modern state. There simply is no alternative for income generation that could potentially raise more revenue at less opportunity costs. There seems to be no substitute for taxes, but also no substitute for the state as a taxing unit. The right to tax is and has always been a mark of power and legitimacy.

Tax sovereignty is considered an important asset for the governments and they are not willing to transfer it in favour of international or supranational body. State`s right to regulate their own tax systems allows differences between national tax systems, while increased economic operations create the context for the most flexible economic actors the opportunity to relocate to the most favourable tax jurisdiction. Nowadays, countries are confronted with the necessity to avoid the transfer of existing tax bases and, if possible, to attract revenues from activities abroad. As a consequence, the states adjust their tax systems according to the tendencies of the mobile capital.

As difficult as circumstances are for tax authorities, globalization is making the situation even more difficult by increasing the relative influence of international factors in promulgating tax rules and collecting (and using) tax revenues, which used to be determined mainly by domestic determinants. Even if globalization does not threaten the state tax sovereignty, it is, nevertheless, a challenge. The greater openness and increased interdependencies between national economies result with increased interdependencies between national tax regimes. These interdependencies confront governments with some new tax policy problems. They include double taxation (the uncoordinated result of two jurisdictions imposing the same or similar tax on the same taxpayer for the same economic activity in the same fiscal period), tax avoidance (as a result of taxpayers' jurisdiction shopping), tax arbitrage (the result of legislative gaps between jurisdictions) and tax evasion (the result of non-transparency of information between jurisdictions), as well as the tax competition among various tax jurisdictions.

Up to date, states have reacted to these issues in two ways. First, they have adopted unilateral measures of new or strengthened anti-avoidance and evasion legislation to stop the mobile tax base from shifting out of the national territory and international cooperation to reinforce national control, mainly through the cross-border exchange of tax information. As time has shown, these harmful tax arrangements could not be solved efficiently by unilateral measures due to their international character. Therefore, the dimension of the tax avoidance requires courageous and coordinated measures adopted by many, if not all tax policymakers, to restore the confidence in the tax system and to ensure that income, capital and profits are submitted to justified fiscal treatment, with respect to the fundamental principle of equity in taxation.

There is no doubt that tax sovereignty is weakening. In order to deal with these tax troubles, states should be ready to surrender at least part of their power to rule taxation and try to cope better with these illnesses by some type of multilateral regulation and standards rather than egoistically protect their formal independence. The international tax regime could only have benefited from more standardized tax rules that would limit the opportunities for exploring the tax mismatches, tax treaty abuses, treaty shopping and aggressive tax planning. On the other hand, the standardization would stop countries from using creative tax solutions to attract foreign capital inflows.

Surely, multilateralism will provide greater efficiency of the international tax system. However, it should not be considered as a limit to the state`s power to tax and an obstacle to tax competition. A well-established and implemented international standard could facilitate more efficient tax competition between countries, one that would focus on the quality of public services provided and on the amount of taxes paid for these services in the concrete country.

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