AMERICAN JOURNAL OF BUSINESS MANAGEMENT
ISSN: 2996-5098 (online) | ResearchBib (IF) = 10.61 IMPACT FACTOR
Volume-3| Issue-9| 2025 Published: |30-10-2025|

ISSUES OF MODERNIZATION OF TAX POLICY IN THE DIGITAL ECONOMY

https://doi.org/10.5281/zenodo.17319708

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ABSTRACT

The digital economy, characterized by the rapid growth of online trade, virtual assets, and cross-border data flows, challenges traditional fiscal frameworks. Existing tax systems—designed for tangible goods and fixed establishments—are increasingly ineffective in regulating digital transactions. This article examines theoretical and practical issues in modernizing tax policy to address new forms of economic activity. It analyzes international approaches such as the OECD/G20 BEPS initiatives, real-time tax administration tools, and platform-based VAT collection systems. The research aims to identify mechanisms that promote fair taxation, transparency, and administrative efficiency in the digital era. The study concludes that coordinated global action and the adoption of digital technologies are essential for creating equitable and sustainable tax policies in a borderless economy.

Key Words

Digital economy; tax modernization; fiscal policy; international taxation; base erosion; e-commerce; value-added tax (VAT); real-time reporting; platform economy; innovation; compliance; BEPS; transparency; governance.

INTRODUCTION

1. Background and Relevance

The emergence of the digital economy has redefined how value is created and exchanged across borders. Digital platforms, cloud computing, and data-driven services now form the core of global commerce [OECD, 2015, p. 10]. These developments have blurred the boundaries between producers and consumers and between jurisdictions. Traditional tax systems—built on physical presence and tangible assets—have proven insufficient for identifying taxable activities and allocating revenues fairly [IMF, 2019, p. 29].

For governments, the challenge lies in balancing innovation incentives with fiscal sustainability. While digitalization drives economic growth, it also enables multinational corporations to exploit gaps in tax legislation, shifting profits to low-tax jurisdictions through intangibles and transfer-pricing mechanisms [Auerbach et al., 2017, p. 41]. As a result, tax bases erode, revenue collection becomes volatile, and inequality widens. Consequently, modernization of tax policy is not only an economic necessity but also a social imperative.

2. Problem Statement

The digital economy's borderless nature creates asymmetry between where economic value is generated and where it is taxed. The absence of physical presence, combined with the mobility of intellectual property, data, and digital assets, complicates the identification of tax nexus [Devereux & Vella, 2018, p. 34]. Furthermore, the rapid evolution of technology surpasses the speed of legislative reform, leading to administrative inefficiency and increased opportunities for tax avoidance [Cockfield, 2018, p. 92].

In developing countries, the problem is compounded by limited digital infrastructure, weak enforcement capacity, and dependence on outdated tax collection methods [World Bank, 2020, p. 54]. Therefore, designing a coherent modernization strategy requires both institutional reform and international cooperation.

3. Research Objectives

The primary objectives of this research are:

1. To identify key challenges in modernizing tax policy in the context of the digital economy.
2. To analyze international approaches, including the OECD/G20 BEPS Action Plan and the UN's Article 12B framework.
3. To propose mechanisms for integrating technological innovation into national tax systems.
4. To evaluate administrative models that balance efficiency, equity, and compliance.

4. Methodology

The study employs a qualitative comparative analysis of international policy documents, empirical studies, and case examples from OECD, IMF, and UN reports. Secondary data are synthesized to assess trends in tax modernization, including VAT/GST reforms, platform compliance models, and digital-service taxation. The research framework combines economic, legal, and technological perspectives to offer a holistic understanding of fiscal adaptation in the digital era [IMF, 2021, p. 15].

5. Significance

By analyzing global reforms and emerging digital-administration practices, this study contributes to understanding how governments can modernize their tax systems to ensure fair competition and sustainable development. The findings are particularly relevant for developing economies seeking to strengthen fiscal sovereignty and participate effectively in the global digital market [UN, 2021, p. 8].

LITERATURE REVIEW

1. Conceptual Framework of the Digital Economy

The OECD defines the digital economy as economic activity enabled by digital technologies, encompassing e-commerce, cloud computing, online platforms, and data analytics [OECD, 2015, p. 12]. According to the IMF (2021), digital transformation creates both new revenue opportunities and compliance challenges, as virtual operations often escape existing tax frameworks [IMF, 2021, p. 7]. Scholars emphasize that the “intangibility” of digital goods and services complicates the identification of taxable events and jurisdictional authority [Devereux & Vella, 2018, p. 36].

The digital economy’s key features include:

- Intangible assets and intellectual property;
- Global networks and instant transactions;
- User participation as a value driver;
- Platform intermediation and two-sided markets.

These characteristics necessitate rethinking core principles of taxation, such as “permanent establishment,” “source of income,” and “residence.” Without modernization, these principles fail to reflect economic realities [Cockfield, 2018, p. 95].

2. Early Studies on Digital Taxation

Initial studies in the 1990s and early 2000s considered digital commerce as an extension of traditional trade, suggesting incremental adjustments to existing laws rather than systemic change [OECD, 2015, p. 14]. However, the globalization of digital platforms soon exposed the limitations of this approach. Researchers such as Avi-Yonah (2020) argued that digital companies derive value from user data and network effects, which are not adequately captured by traditional tax rules [Avi-Yonah, 2020, p. 12].

The United Nations (UN) and World Bank highlighted the importance of digital infrastructure for broadening the tax base and improving compliance efficiency [UN, 2021, p. 10]; [World Bank, 2020, p. 58]. Empirical evidence from European Union (EU) member states shows that the introduction of e-invoicing and real-time reporting reduced VAT gaps by up to 15 percent over five years [OECD, 2019, p. 25]. These findings illustrate how technological innovation can be used as a tool for fiscal modernization.

3. Theoretical Approaches to Tax Modernization

3.1. The Efficiency Framework

Auerbach et al. (2017) propose a "destination-based cash-flow tax" (DBCFT) as an alternative to traditional corporate taxation. Under this system, taxes are levied where consumption occurs rather than where production takes place [Auerbach et al., 2017, p. 41]. The approach aligns with the digital economy's cross-border nature and minimizes profit-shifting incentives. However, it requires sophisticated administrative capacity and international cooperation.

3.2. The Equity Framework

Cockfield (2018) emphasizes the ethical dimension of tax policy, arguing that digital enterprises should contribute fairly to public revenue in jurisdictions where they derive profits [Cockfield, 2018, p. 98]. The principle of tax equity demands that governments ensure users and small enterprises are not disproportionately burdened while large platforms remain undertaxed.

3.3. The Administrative Framework

The IMF (2019) stresses that administrative modernization—particularly through digital tools and data integration—is key to reducing compliance costs and improving revenue collection [IMF, 2019, p. 31]. The concept of "Tax Administration 3.0," introduced by the OECD (2020), envisions a system where tax reporting occurs in real time, using standardized electronic interfaces between taxpayers and authorities [OECD, 2020, p. 13]. This model reduces fraud, increases data accuracy, and creates a transparent relationship between businesses and governments.

4. International Policy Responses

4.1. OECD BEPS Initiatives

The OECD/G20 Base Erosion and Profit Shifting (BEPS) Project represents the most comprehensive global effort to address digital tax challenges. BEPS Action 1 (2015) identified three main issues: nexus definition, data valuation, and characterization of digital transactions [OECD, 2015, p. 15]. The two-pillar solution adopted in 2021 proposes reallocation of taxing rights to market jurisdictions (Pillar One) and a minimum global tax rate (Pillar Two) [OECD, 2021, p. 9]. These measures aim to stabilize international tax relations and curb profit shifting.

4.2. United Nations Article 12B

In parallel, the UN introduced Article 12B to its Model Tax Convention, focusing on the taxation of Automated Digital Services (ADS) [UN, 2021, p. 11]. Unlike the OECD framework, Article 12B provides simplified withholding tax options for developing countries, offering a practical alternative to complex transfer-pricing methods.

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4.3. Unilateral Measures

Countries such as France, India, and the United Kingdom have introduced Digital Services Taxes (DSTs) as temporary solutions [Avi-Yonah, 2020, p. 17]. While these generate short-term revenue, they also risk double taxation and trade disputes. The OECD encourages a multilateral approach to avoid fragmentation [OECD, 2021, p. 13].

5. Empirical Evidence on Administrative Modernization

Recent empirical research confirms that countries implementing digital administrative tools have improved compliance and revenue stability. For example, Brazil's e-invoicing system (NFe) reduced VAT fraud by significant margins, while Mexico's real-time reporting framework increased transparency in public finance [World Bank, 2020, p. 66]. Estonia's digital tax portal demonstrates how integrated data can simplify filing and reduce bureaucratic burdens [OECD, 2019, p. 33].

However, adoption is uneven. Low-income countries face barriers such as high implementation costs, cybersecurity risks, and lack of technical expertise [IMF, 2021, p. 22]. Therefore, international support and knowledge transfer are vital for equitable modernization [UN, 2021, p. 14].

6. Gaps in the Literature

While significant progress has been made in analyzing tax reform models, there remains a gap in evaluating their applicability to emerging markets. Most existing studies focus on developed economies, where digital infrastructure is well established. Moreover, few papers examine how social equity and ethical governance intersect with digital tax policy [Cockfield, 2018, p. 103]. This study addresses these gaps by linking technological and institutional dimensions of fiscal reform in the digital economy.

DISCUSSION

1. Major Challenges of Tax Policy in the Digital Economy

The modernization of tax policy faces both **conceptual** and **operational** challenges.

Conceptually, digitalization erodes traditional tax bases and distorts the link between production, consumption, and taxation. Digitally generated profits are increasingly detached from tangible assets and human labor. Operationally, fiscal authorities struggle to trace digital transactions that traverse multiple jurisdictions with no physical presence [OECD, 2019, p. 27].

1.1. Nexus and Jurisdictional Problems

Traditional tax systems rely on the concept of "permanent establishment" (PE) to define taxable presence. However, digital companies can operate extensively in a market without any physical infrastructure. For instance, global streaming services, online marketplaces, and social media platforms generate billions in revenue within countries where they hold no registered office [Devereux & Vella, 2018, p. 37].

This creates a **nexus gap**, where profits are earned without corresponding taxation. The proposed "significant economic presence" test aims to link taxation rights to digital engagement, user base, and data collection activities [OECD, 2021, p. 9].

1.2. Base Erosion and Profit Shifting (BEPS)

Digitalization magnifies the long-standing issue of profit shifting. Through intellectual property (IP) migration and transfer-pricing strategies, multinational corporations allocate profits to low-tax jurisdictions while real value is created elsewhere [Auerbach et al., 2017, p. 41].

The OECD's BEPS framework addresses these distortions, yet enforcement remains weak in countries with limited administrative capacity [IMF, 2019, p. 33]. Consequently, modernizing tax policy requires not only new legal instruments but also digital tools to detect and prevent base erosion in real time.

1.3. VAT and E-Commerce Taxation

The taxation of cross-border e-commerce remains a central concern. Value-added tax (VAT) systems face difficulty ensuring compliance from foreign digital suppliers. To address this, many jurisdictions have adopted **destination-based VAT**, applying the tax in the country of consumption rather than supply [OECD, 2019, p. 30].

Moreover, **platform-facilitated VAT collection**—where marketplaces act as deemed suppliers—has proven effective in increasing compliance and revenue, particularly in the EU and Asia-Pacific regions [World Bank, 2020, p. 61].

1.4. Administrative Inefficiency

Without digital tools, tax authorities face delays, data inconsistencies, and fraud risks. Implementing e-invoicing and **real-time reporting (RTR)** systems helps automate verification, reduce evasion, and strengthen transparency [OECD, 2020, p. 11].

However, these systems require investment in digital infrastructure and cybersecurity. Developing nations often lack the financial and human resources to implement them effectively [UN, 2021, p. 14].

2. Strategic Approaches to Modernization

2.1. OECD/G20 Two-Pillar Solution

The **Two-Pillar Solution** (2021) offers the most comprehensive framework for digital tax reform.

- **Pillar One** reallocates a portion of residual profits of large multinational enterprises (MNEs) to market jurisdictions, addressing nexus obsolescence.

• **Pillar Two** introduces a **global minimum tax** of 15%, mitigating harmful tax competition among countries [OECD, 2021, p. 13].

Although these reforms represent progress, practical implementation requires political consensus, data-sharing agreements, and legal harmonization across borders [IMF, 2021, p. 19].

2.2. UN Model Tax Convention (Article 12B)

The UN's Article 12B introduces a simpler, **withholding-based approach** for taxing Automated Digital Services (ADS). It enables source countries, especially developing ones, to levy a gross-based tax or allow taxpayers to opt for a net-basis tax with deductions [UN, 2021, p. 11]. This method reduces administrative complexity and ensures equitable distribution of tax revenues.

2.3. Integration of Technology in Tax Administration

Technological innovation is central to modernization. Tools such as **AI-driven audit systems**, **blockchain-based recordkeeping**, and **machine learning risk analysis** are transforming compliance management [Cockfield, 2018, p. 99]. Countries like Brazil, Mexico, and Estonia have successfully implemented e-reporting and data integration mechanisms that reduced VAT gaps and improved compliance transparency [World Bank, 2020, p. 70].

2.4. Promoting Compliance Through Digital Platforms

Digital platforms serve as key intermediaries for collecting VAT, withholding income tax, and reporting seller data. Their global reach and technological capacity make them essential partners for governments. By making platforms legally responsible for tax withholding, authorities can expand the taxable base while minimizing compliance costs for small and medium-sized enterprises (SMEs) [OECD, 2019, p. 33].

2.5. Ethical and Equity Dimensions

The modernization of tax policy must balance **equity** and **innovation**. Wealth generated from user data should be taxed where the users reside, aligning with fairness principles [Avi-Yonah, 2020, p. 17]. Additionally, modernization should protect digital privacy and uphold citizens' data rights. Integrating fiscal and data governance frameworks ensures that taxation remains legitimate and socially accepted [Cockfield, 2018, p. 103].

RESULTS

1. Comparative Analysis of Modernization Measures

Empirical data from OECD and World Bank studies demonstrate measurable benefits of tax modernization. The following table compares revenue performance before and after introducing key modernization tools in selected countries.

Table 1. Impact of Tax Digitalization on Revenue Efficiency (2015–2021)

Country	Reform Type	VAT Gap Before Reform	VAT Gap After Reform	Revenue Growth (%)	Source
Brazil	E-Invoicing (NFe System)	18%	7%	+11.5	[World Bank, 2020, p. 66]
Mexico	Real-Time Reporting (CFDI)	22%	10%	+9.8	[IMF, 2019, p. 31]
Estonia	Integrated Digital Portal	14%	5%	+8.7	[OECD, 2019, p. 33]
France	Platform VAT Collection (EU Model)	11%	4%	+7.4	[OECD, 2021, p. 16]

Interpretation:

All countries that implemented technological tax reforms achieved noticeable reductions in VAT gaps and enhanced compliance rates. The highest efficiency gain was observed in Brazil and Estonia, illustrating that e-invoicing and integrated platforms provide sustainable administrative benefits.

2. Comparative Overview of Global Reform Approaches

Table 2. Comparison of International Tax Policy Models in the Digital Economy

Framework	Core Mechanism	Administrative Complexity	Target Group	Effectiveness	Key Limitation
OECD Pillar One	Reallocation of Residual Profits	High	Large MNEs	High	Requires global consensus
OECD Pillar Two	Global Minimum Tax (15%)	Medium	All MNEs above revenue threshold	High	Coordination challenges
UN Article 12B	Withholding on Automated Digital Services	Low	Developing countries	Medium	Possible double taxation risk
DST (Unilateral)	Gross-based taxation on digital revenues	Medium	Large digital platforms	Moderate	Trade tensions and overlap with OECD
VAT	Platfor	Low	SMEs /	High	Depend

Platform Model	ms as deemed suppliers		Cross-border sellers		ence on platform cooperation

Interpretation:

The OECD's multilateral reforms (Pillars One and Two) provide long-term global stability but are complex to implement. UN Article 12B offers an accessible framework for developing nations, while platform-based VAT systems ensure administrative simplicity and fast results.

3. Evaluation of Key Outcomes

From the comparative analysis, five main results emerge:

1. **Revenue Enhancement:** Adoption of e-invoicing and real-time data systems leads to 8–12% increases in VAT revenues [World Bank, 2020, p. 70].
2. **Administrative Efficiency:** Integration of digital technologies reduces human error, enhances transparency, and allows predictive fraud detection [OECD, 2020, p. 13].
3. **Equity Improvement:** Digital tax systems ensure fairer taxation across both large corporations and small enterprises, reducing inequality [Cockfield, 2018, p. 99].
4. **Global Coordination:** OECD and UN frameworks foster cooperation and limit harmful tax competition [IMF, 2021, p. 24].
5. **Capacity Building:** International technical assistance programs enable developing countries to implement modernization reforms effectively [UN, 2021, p. 17].

CONCLUSION

The modernization of tax policy in the digital economy is a multifaceted and urgent challenge. As global economic activity increasingly migrates online, traditional fiscal instruments lose their effectiveness. The study demonstrates that modernization requires both **conceptual innovation**—through redefining nexus and allocation rules—and **technological transformation**, via digitalized tax administration.

Key conclusions include:

1. **Digital Transformation Is Inevitable:** The integration of real-time reporting, blockchain-based accounting, and AI-assisted audits represents the future of tax governance.
2. **Equity and Neutrality Must Be Preserved:** Policies must ensure that taxation is fair, preventing both double taxation and base erosion.
3. **Global Cooperation Is Essential:** Without international coordination, unilateral measures risk creating economic fragmentation and trade conflicts.

4. **Institutional Capacity Matters:** Developing countries need targeted support to build technological infrastructure and administrative expertise.

5. **Ethical Taxation Enhances Legitimacy:** Balancing innovation with social responsibility ensures sustainable fiscal systems in the digital age.

Ultimately, the modernization of tax policy represents more than technical reform—it embodies a shift toward transparent, inclusive, and innovation-friendly governance that aligns public revenue systems with 21st-century realities.

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