CATA 40th Technical Conference

Statement of Outcome

1. The 40th edition of the annual CATA Technical Conference was held in Penang, Malaysia from 11-14 November 2019. The keynote address was given by the Hon. Minster for Finance of Malaysia.

2. The conference was attended by 134 delegates from 22 member countries. Also in attendance were delegates from other tax administrations, international tax organisations, research institutions and private enterprises.

3. A meeting for the Heads of Delegation of the member countries was held on the margins of the conference. Arising from that meeting members expressed their appreciation of CATA to the Government of Malaysia through its tax body the Inland Revenue of Malaysia for hosting the 40th Annual Technical Conference here in Penang, Malaysia.

4. The theme for this technical meeting is 'Addressing the Shadow Economy and Digitalisation in Securing Revenue for Sustainable Development'.

5. The conference deliberations were structured in plenary sessions and syndicate group discussions. The plenary sessions provided a broad overview of the main topics of discussions mainly digitalisation in taxation and the shadow economy. These topics were further discussed in detail by the syndicate groups.

6. Arising from these discussions some of the following observations were made in respect of taxation of digital economy:
    - The shadow economy is as an important component of the tax gap in many CATA members countries affecting tax revenues. It caused consistent loss

of the much-needed tax revenue required for a country's growth and sustainable development.

- We live in an exciting era, where we can hail a ride, order our food, book an accommodation or flight, purchase various products, track our fitness, and performed a myriad of activities such as making payment or banking without leaving the comfort of our home.
- This exponential growth of digital technology has transformed our lives in an unprecedented way. Emerging technologies such as artificial intelligence (AI), big data analytics, block chain and the Internet of Things (IoT) are cutting across every sector – both private and public alike. These technologies are transforming and disrupting not only traditional business models and market but extend much beyond.
- Technology is shifting citizen expectations across the globe. These higher expectations directly translate to higher expectations for government services—but many public-sector institutions lag behind these expectations.
- Most countries concur that business as usual is no longer feasible for tax administrators. Similarly, tax administrators too need to seize these opportunities created by digitalization in order to innovate to remain relevant and find new ways of doing things, to enhance services of the tax administrators as a whole.to transform the administration of taxation.
- Many countries have embarked on some form of digitalization and are at different level of transformation of the tax administrations services. Most concurred digitalisaton of the tax administration needs to be an on-going process and not a one-off implementation as digital technology are rapidly and perpetually evolving.

- The immediate driver for change in international law is the challenge posed by digitalization of the global economy in many countries. Most countries are concerned that that some very profitable, highly digitalised companies pay very little tax in country where they do businesses. A major challenge posed by digital economy is its ability to use tax existing rules to avoid paying their

fair share of taxes. While tax avoidance is not exclusive to digital platforms, some of their inherent characteristics such as heavy reliance on intangible assets and mobility may facilitate their use of for tax avoidance. A significant proportion of the value generated in the digital economy stems from users through the data they produce. Members countries also agreed on a number of key aspects of taxation of the digital economy, including:

i. Existing tax rules cannot keep pace with the scale and scope of the digital economy;
ii. While the OECD's work on digital economy towards a consensus is considered beneficial, however some countries considered it neither preferred nor optimal. For some countries, unilateral measures may be the preferred course of action. Countries are worried that they may not be able to receive a fair share of tax generated from taxation of digital economy based on the Unified Approach proposed by OECD.
iii. No country can effectively deal with the digital economy on its own; even if a common approach is not achieved, countries will still need to cooperate closely in order to effectively tax cross-border digital economic activity.
iv. Other countries, while preferring to achieve a consensus solution, still may want to implement interim unilateral measures, to prevent undue loss of revenue, decreased competitiveness, and a lack of fairness to domestic businesses. However, it is feared that such action, could undermine global efforts to seek alignment at international level and create the risk of double taxation.
v. Any global consensus-based solution must ensure that all economies, large and small, developing and developed, receive a fair share of revenue generated from taxation of the digital economy.

7. Shadow economy is described as economic activities, whether legal or illegal, which are required by law to be fully reported to the tax administrations, but which are not reported, and which therefore go untaxed unlike activities which are so reported. Countries agreed that illicit financial flow can contribute to shadow

economy but did not provide any statistics. Income generated from various activities in the shadow economy are commonly hidden by the following means:

- Offshore bank accounts
- Cash stacks and cash transactions
- Cross border cash movements
- The use of digital currencies (virtual and Cryptocurrencies)
- Money laundering activities

8. Shadow economies are largely prevalent in SME sector, trade and services, cash-driven economies and affecting VAT, custom duties, stamp duties, income tax, etc.

9. In order to achieve responsible cross border data exchanges, countries agree the following can be done:

- Countries must design bilateral and multilateral legal instruments so as to provide the legal basis for cross border data exchanges and to define the scope of the exchange;
- Both automatic, upon request, and spontaneous exchanges would be needed;
- Data exchange function would need to be clearly reflected in Organizational Structures of tax administrations;
- Resources (human, financial and material) must be allocated to ensure effective functioning of the data exchange;
- Monitoring and evaluation mechanism must be put in place to assess implementation effectiveness;
- Political will is of importance for establishment of an enabling environment to support responsible cross data exchanges.

Exchange of information (EOI) and cooperation in investigations and audits

10. International cooperation through information exchange such as exchange of information in request (EOIR) and common reporting standards (CRS) and

cooperation in investigation and audits are effective in ensuring responsible cross border exchange and overcoming the cross-border shadow economy.

11. Countries agreed that information exchange plays a vital role in investigation and audit. It is extremely effective as the exchange and access of international information can make or break an investigation. Besides that, the exchange of information must be done in a responsible manner and within the framework of EOI and CRS. It is definitely one of the largest tools to reduce the possibility of tax evasion.

12. EOIR is found to be one of the relevant mechanisms for obtaining essential information to understand and capture activities taking place in the shadow economy. However, this mechanism is hinged on the “foreseeably relevance” standard which essentially require tax authorities (i.e. competent authorities) to have certain background information (taxpayer, tax type, tax risk, etc) about the tax matter under scrutiny. As the background information may not always be available, this mechanism alone cannot effectively expose and capture all activities in the cross-border shadow economy.

13. CRS involves automatic exchange of information on financial accounts of individuals and entities, prepared in a common standard or format, and transmitted using the common transmission system (CTS). As some of the income earned in the cross-border shadow economy is likely to be kept in offshore bank accounts, CRS would therefore clearly help to expose such income. However, CRS would need to be complemented by EOIR for it to be more effective in overcoming the shadow economy.

Cooperation through Audits and Investigations

14. These mechanisms mainly involve joint audits/investigation, simultaneous tax examination and tax examination abroad. However, these mechanisms are rarely

used, particularly in developing countries due to various challenges related to coordination, budgets availability etc. Therefore, the role and effectiveness of these mechanism in overcoming cross border shadow economy is likely to remain limited unless a new impetus is introduced to encourage their use.

15. The following are suggested strategies by countries to curb cross-border shadow economy:

- Encourage innovations targeting to reduce cash transactions in the economy, without corresponding increase in transactional costs, particularly in developing countries.
- Enhancement of the international cooperation to foster effective Exchange of Information through utilization of all EOI mechanism (CRS, EOIR and Spontaneous)
- Effective implementation of Cash Declaration requirements at all arrival or departure points.
- All Governments around the globe must find ways to ensure effective regulation of digital currency (virtual and cryptocurrency) transactions.
- Take advantage of the trade blocs such as East African Community (EAC), African Union (AU), among others.
- Build competence on ability to analyze data to inform tax administration.

Interactions between digitalization and the shadow economy

16. Digitalization has generally introduced opportunities for the growth of the shadow economy particularly in developing countries as follows:

- Digitalization has introduced various platforms (social networks, websites, blogs, etc) that facilitates unregistered sole proprietary businesses to market and sale assorted goods and services. In developing countries these sales are frequently concluded on the

basis that payments would be made in advance through money transfer platform and delivery of the goods/services is done later. Some of the traditional sales stores are being closed or reduced in size in favor of digital sales and option. The income generated from digital sales is largely unreported and/ or untraceable/unverifiable.

- Digitalization has created opportunities for new technologically driven businesses to emerge. The example of such businesses includes those developed based on the concept of sharing economy (sharing of ride, tractor, trucks, accommodation, and many others). However, in practice it may be difficult to trace and ascertain the income that individuals generate from such businesses.
- The use of social media networks and digital technologies helps users to create network of acquaintances which can be maintained and used for various purposes including as a platform for launching various sales and marketing campaigns. This may create opportunities for business transactions to be concluded outside the formal setting which may end up facilitating the growth of shadow economy.
- Therefore, it would be correct to say that on one hand digitalization could contribute in increasing the size of the shadow economy especially when tax authorities fail to catch up with its pace of creating new businesses. The shadow economy increases particularly when tax authorities fail to invest in computing technologies that could easily identify all essential details of individuals that make sales through digital platforms. This also occurs when the pace of development of digital technologies surpasses by far the pace of development of legal and regulatory frameworks of countries, particularly in the developing world.

17. On the other hand, digital footprints may help to uncover the shadow economy. In practice many footprints are left when individuals and entities conduct businesses through digital platforms or take advantage of the new business opportunities

created by the development of the Information and Communication Technologies. Clearly tax administrations could collect, process and interpret these footprints which could inform a lot about the nature of businesses conducted in the shadow economy. This could significantly help to uncover income generating activities conducted in the shadow economy and thus would help to bring them in the tax net.

18. However, the collection and processing of the footprints would require heavy investments in computer analytics technologies - a tool which is yet to be effectively exploited by most tax administrations in developing countries. Deliberate and concerted efforts are therefore needed to invest in these technologies when there are economic justifications.

19. Informal economic activities flourish mainly due to lack of practical or economically justifiable mechanisms for their tracing, identification and capture into the tax net. Accordingly, data analytics and other innovative identification technologies could help tax administrations to obtain essential details on activities in the shadow economy. The details obtained would help to formalize and thus contain these activities.

20. Unlike cash payments, digital or bank payments leave behind sufficient footprints that can be collected and analyzed. These can provide valuable clues concerning identity of the payer and the subject of payment. Further, with digital or bank payments, Government regulator(s) can easily provide oversight on all digital or bank payments and may put in place legal and regulatory measures requiring banks or facilitators of digital payments to ensure certain key information, on transactions conducted, are obtained and maintained. The information obtained in the course of these transactions could help to expose any activities in the shadow economy. This exposure could easily facilitate integration of the shadow economy into the formal economy.

21. There are many virtual and cryptocurrencies in the world today. Unfortunately, these are mostly unregulated due to their design and nature. These currencies are stored or transacted using special computer software or applications. Transactions are facilitated by the internet through highly secured and dedicated privately owned networks. These transactions are therefore highly private and invisible to most governments. As a result, there is a challenge for a country or economy to exercise full control and regulation over virtual currencies.

22. Due to the high degree of privacy offered by virtual currency, they could be used to facilitate storage or transfer of income earned from activities in the shadow economy thus encouraging these activities to continue leading to possible expansion of the shadow economy.

23. Digitalized methods of doing business could enhance cross border shadow economy particularly in situations where governments fail to swiftly take measures (legal, regulatory and administrative) to ensure collection and analysis of information on all players involved in digitalized businesses. However, digitalized methods of doing businesses leave reliable footprints that could be traced and analyzed using data analytics technologies. Such footprints are in most cases not left behind with traditional methods. Therefore, while digitalized methods of doing business can enhance cross border shadow economies, this is considered to be a very short-term phenomenon which is unlikely in the case of traditional methods based on cash payment transactions.

14th November 2019