

## The politics of taxing multinational firms in a digital age

Margarita Gelepithis & Martin Hearson

To cite this article: Margarita Gelepithis & Martin Hearson (2021): The politics of taxing multinational firms in a digital age, Journal of European Public Policy, DOI: [10.1080/13501763.2021.1992488](https://doi.org/10.1080/13501763.2021.1992488)

To link to this article: <https://doi.org/10.1080/13501763.2021.1992488>



© 2021 The Author(s). Published by Informa UK Limited, trading as Taylor & Francis Group



Published online: 17 Dec 2021.



Submit your article to this journal [↗](#)



Article views: 221




View related articles [↗](#)



View Crossmark data [↗](#)

# The politics of taxing multinational firms in a digital age

Margarita Gelepathis<sup>a</sup> and Martin Hearson <sup>b</sup>

<sup>a</sup>Department of Politics and International Studies, University of Cambridge, Cambridge, UK;

<sup>b</sup>Institute of Development Studies, University of Sussex, Brighton, UK

## ABSTRACT

Taxing multinationals is politically difficult because of the structural power of mobile firms within the global economy, and this structural power is expected to increase in the digital age. Recently however there has been a breakdown in the international corporate tax consensus that structured tax competition over the past century. A new norm of international taxation has emerged whereby states claim the right to tax corporate income based on presence in consumer markets. Our paper explains this unexpected reassertion of state power. Building on previous accounts of large-scale change in policy norms, we show how the emergence of digital business models led to a new tax consensus by setting in train a process of policy contestation that allowed countries to levy taxes on multinationals unilaterally, without fear of capital flight.

**KEYWORDS** Digitalisation; ideas; multinationals; redistribution; tax

## Introduction

The politics of taxing multinational enterprises (MNEs) is one of the most challenging contemporary aspects of the politics of taxing the rich. In the US, corporate tax cuts are primarily responsible for the steep post-war decline in tax rates of the top 0.1% of income earners (Saez & Zucman, 2020, p. 55). More generally across rich democracies, a striking decline in statutory corporate tax rates combined with widespread erosion of the corporate tax base has contributed to a forty-year shift in the burden of taxation away from capital towards labour, and creeping tax system regressivity (OECD, 2018; Saez & Zucman, 2020). The lowest effective corporate tax rates are systematically paid by the most valuable and highly digitalised MNEs such as Google, Amazon and Facebook, facilitating the concentration of wealth in a small number of companies and the individuals who control them (European Commission, 2018; Zuboff, 2018).

**CONTACT** Margarita Gelepathis  mg2000@cam.ac.uk

© 2021 The Author(s). Published by Informa UK Limited, trading as Taylor & Francis Group

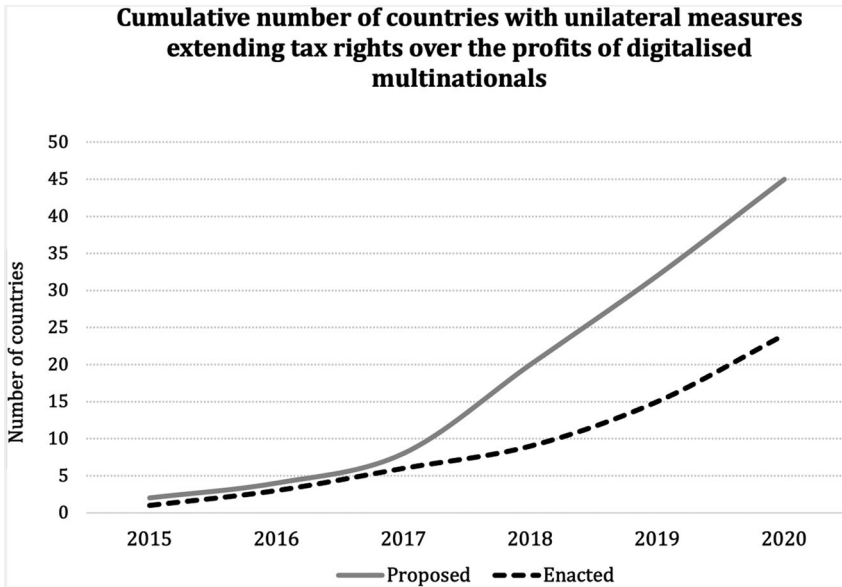
This is an Open Access article distributed under the terms of the Creative Commons Attribution-NonCommercial-NoDerivatives License (<http://creativecommons.org/licenses/by-nc-nd/4.0/>), which permits non-commercial re-use, distribution, and reproduction in any medium, provided the original work is properly cited, and is not altered, transformed, or built upon in any way.

There is strong consensus among political economists that these developments are attributable to the structural power of mobile firms within the global economy (Culpepper, 2015; Lindblom, 1980). This structural power emerges in the context of a century-old international tax system characterised by two features: firms are taxable on profits generated in a country only when physically present there, and the share of profits that a country can tax is determined through transfer pricing rules which attribute profits according to how much value is generated in a jurisdiction. These features produce tax competition that puts downward pressure on tax rates. Countries are reluctant to unilaterally increase taxes on MNEs for fear that mobile factors of production will move to lower tax jurisdictions, leading to the loss of jobs, investment and other economic benefits. Collective action at the international level is similarly prevented by the temptation to attract mobile factors of production (Basinger & Hallerberg, 2004; Genschel, 1999; Strange, 1996; Swank, 2016). This 'real' tax competition is exacerbated by 'virtual' tax competition in which offshore financial centres compete to host the paper profits of MNEs.

Digitalisation has made taxing MNEs still more difficult. Notwithstanding the reliance of many highly digitalised multinationals on geographically embedded tacit and co-specific skills (Iversen & Soskice, 2019), high value-added business functions are sensitive to both real and virtual tax competition. MNEs increasingly create profit from intangible rather than physical assets: software, algorithms, and electronic consumer data. These assets can be relocated to low-tax offshore jurisdictions, the basis of a conceptual arbitrage where firms with large portfolios of intangible assets use regulatory stipulations designed for a different era to strategically manage their fiscal exposure (Bryan et al., 2017). Intangible assets also allow firms to have value-generating entanglement in an economy with little or no physical presence, and hence little or no tax liability. In the global economy of the digital age, many of the largest multinationals are more 'footloose' than ever.

Recently, however, countries introduced unilateral measures that reasserted their power to tax precisely these most footloose of multinationals. At the time of writing, legislation had been enacted in 29 countries and was under consideration in a further 19 (Figure 1). These measures created new tax liabilities on corporate income generated by supplying goods and services digitally within a country's borders (OECD, 2018). Perhaps the most contentious such measures, Digital Services Taxes (DSTs), were already in force in 12 countries: Argentina, Austria, France, India, Italy, Kenya, Poland, Sierra Leone, Spain, Tunisia, Turkey and the UK.

While the magnitude of each of these unilateral measures was limited, taken together they amounted to an unprecedented breakdown in an international consensus that has structured corporate tax competition over the past century (McLoughlin, 2019; Smyth & Giles, 2021). In response to this



**Figure 1.** Unilateral measures extending tax rights over digitalised multinationals.

breakdown, the issue of how to ensure multinationals pay their fair share of taxes in the digital age rose to the top of the international tax policy agenda. A new consensus has emerged whereby MNEs can be taxed where their consumer markets are, even in the absence of a physical presence. By tying corporate tax liabilities to immobile consumer markets, this new norm enables countries to tax footloose multinationals more effectively and reallocates the right to tax corporate profits across countries. It constitutes a surprising reassertion of state power relative to the powerful and highly footloose multinationals of the digital age.

Our objective in this paper is to explain how the idea of taxing corporate income based on consumer market presence ('market-based' corporate taxation) emerged as a new international tax norm. Our explanation is based on historical analysis of policy discourses within the transnational corporate tax policy community. In light of the OECD's central role within this community, we draw heavily on its reports and consultations dating back to the 1990s when the original tax consensus was still strong. Informed by theoretical expectations, we also draw on policy reports, consultation documents and press releases from the European Union, National Treasuries and Finance Ministries, and specialist press coverage accessed through the Tax Notes database.

Our explanation involves two mechanisms through which the new international tax norm took root as governments responded to the disruptive impact of digital business models. (1) The normative framing of a minority

policy idea; (2) the broadening of policy contestation. Together, these explain how digitalisation brought about the unilateral tax measures that opened the door for transformative change. In a nutshell, we argue that the rise of digital business models provides a new, normative rationale for the hitherto minority idea of market-based corporate taxation. This new rationale chimes with the public mood, and there has been a broadening of policy contestation beyond the tax experts whereby public facing political leaders have mobilised in support of market-based taxation. Since consumer markets are immobile and can be taxed without fear of capital flight, the taxation of multinationals has been redefined as a soluble policy problem amenable to collective action, and market-based corporate taxation has emerged as a new international tax norm.

In the next section we review the political economy literature on the politics of taxing MNEs, which we argue stops short of explaining the puzzle of this paper. In Section Three, we outline how Public Policy theories can help explain our puzzle, and in Section Four we present our empirical analysis. We conclude by discussing our historical narrative in relation to the theoretically salient processes that it highlights, and we offer some critical reflections on the distributional consequences of the recent tax developments.

### **Theorising the politics of taxing of multinationals: international and comparative political economy (IPE and CPE)**

Research in the IPE tradition views the taxation of MNEs as a policy area that has until recently been characterised by ‘quiet politics’. Shielded from domestic electoral attention, it was primarily shaped by a transnational policy community, a group of elite professionals from public and private backgrounds (Christensen, 2021; Hearson, 2021; Seabrooke & Wigan, 2016). The community is centred on the OECD, the organisation whose expert-crafted ‘Model Convention’ codifies an international consensus on the taxation of multinational firms (Genschel & Rixen, 2015, p. 163). It includes civil servants, government-appointed experts and professional stakeholders with substantial technical expertise (Christians, 2010). The norms constructed by this community inform not only bilateral treaties, but also national tax laws. IPE scholarship considers these norms to be stable, resistant to change, and to delimit the set of acceptable options in the minds of policymakers.

Recent IPE literature acknowledges significant change in global tax cooperation (Ahrens & Bothner, 2020; Christensen & Hearson, 2019; Hakelberg & Rixen, 2020). It attributes this change to shifts in the distribution of economic power between countries and the preferences of states most endowed with it (Hakelberg, 2020; Hearson & Prichard, 2018; Lips, 2019b), or to interventions by activists from outside the tax policy community (Murphy-Gregory et al., 2020; Seabrooke & Wigan, 2016). Nonetheless, IPE

research continues to emphasise the stability of the international corporate tax regime, portraying a struggle between political pressures to depart from longstanding foundational norms and an international expert community that successfully defends these norms (Brugger & Engebretsen, 2020; Buttner & Thiemann, 2017; Christensen, 2021; Ylönen & Teivainen, 2017).

CPE research takes the norms that structure tax competition as a given. Within the stability of the international tax system, multinational firms have structural power because of their ability to shift investment into low tax environments. Although firms that rely on high, specific skills may be more willing to accept somewhat higher overall tax burdens (Garrett, 1998; Hall & Soskice, 2001), 'business' is on the whole expected to use its structural power homogeneously to exert downward pressure on corporate taxes (Culpepper, 2015). This downward tax pressure is likely to be weaker where business is less coordinated (Beramendi & Rueda, 2007; Martin, 2015; Steinmo, 1989), and state resistance to downward tax pressure is likely to be greater from left-of-centre (Basinger & Hallerberg, 2004; Ganghof, 2006) or indebted governments (Swank, 2016), in CMEs (Hays, 2003). Overall, the theoretical picture that emerges is one of policy variation within the confines of international tax competition.

### Theorising the taxing of multinationals: public policy

By emphasising the resilience of fundamental international corporate tax norms (IPE), and political contestation within the confines of these norms (CPE), Political Economy scholarship stops short of explaining the puzzle of this paper. How then can we understand the adoption of unilateral measures that fall outside the regime's longstanding norms, and changes to those norms themselves? How can we explain the re-assertion of state power relative to multinationals in the digital age?

A rich theoretical tradition within Public Policy is comfortable explaining long periods of policy stability, as well as occasional transformative departures from the status quo. Key for our purpose of explaining the recent change in international corporate tax norms is a conceptual distinction between *policy problems* on the one hand, and *conditions* (Kingdon, 2003, p. 109) or *difficulties* (Stone, 1989; Wildavsky, 1979) on the other. Policy problems are potentially soluble and therefore appropriate targets of policy, while conditions or difficulties are situations which may be undesirable but for which no policy solutions are seen to exist. This distinction highlights an important reason why policy norms can remain stable even in the face of significant pressure, for example from governments under financial or electoral pressure to levy higher taxes on multinationals.

Tax competition has long been seen as an unavoidable condition of the global economy rather than as a soluble policy problem – both by the tax

policy community that is the subject of IPE scholarship, and by the national political leaders of CPE scholarship. In a tax system based on physical presence, capital mobility puts downward pressure on tax rates and collective action by states is prevented by the temptation to attract mobile factors of production (Basinger & Hallerberg, 2004; Genschel, 1999; Strange, 1996; Swank, 2016).

Policy conditions or difficulties may sometimes be redefined as soluble problems, opening a window of opportunity for large-scale change (Kingdon, 2003; Stone, 1989). Our analysis shows that tax competition became a soluble problem only when a policy idea emerged that made unilateral action by states possible. This policy idea was the taxation of corporate income based on consumer market presence. The immobility of consumer markets allowed countries to levy such 'market-based' taxes without fear of capital flight. Unilateral actions became feasible where previously they would have had to be coordinated to avoid deterring investment.

Where did this transformative policy idea come from, and how did it rise to prominence when it did? Theories of large-scale change in public policy recognise that new policy solutions may emerge when confidence in established ideas has been shaken by their inability to diagnose and treat policy problems (Béland & Cox, 2015; Hall, 1993; Schmidt, 2002). As we detail in the following section, established tax norms were shaken by their incompatibility with digital business models, in particular because they used an MNC's physical footprint in a jurisdiction as the defining criterion of its taxable presence. Digitalised businesses were able to generate considerable revenues in a country without incurring commensurate tax liabilities on their profits.

The policy solutions that emerge during such times are unlikely to be completely 'new' however (Kingdon, 2003, p. 141). They are usually re-brandings or tweaks of older ideas that form 'minority' discourses alongside the mainstream ideas of expert communities (Cobb & Elder, 1972; Greer, 2015, p. 423; Kingdon, 2003). The emerging norm of market-based taxation is traced in our analysis back to the 1990s when it was a minority idea among academic economists.

Key to a minority idea rising to challenge a policy monopoly is its mobilisation by political actors (Baumgartner & Jones, 2009; Hall, 1993; Kingdon, 2003). The public policy literature identifies several mechanisms causally involved with the successful mobilisation of policy ideas, two of which are relevant for explaining the recent changes in international tax norms.

The first mechanism is *a broadening of policy contestation* beyond the epistemic community. Baumgartner and Jones (2009) and Hall (1993) show how stable policy monopolies can be disrupted by the broadening of policy discussions to include new actors with different ideas or interests. A policy area previously the sole remit of a particular epistemic community may attract the attention of new governmental departments or regulatory

bodies for instance, and of the mainstream rather than the specialist media. Such new political actors mobilise certain expert views and technical arguments, and 'catapult' them onto the public agenda (Baumgartner & Jones, 2009; Hall, 1993, p. 288).

Where the new actors involved in the policy discussion are public facing political leaders, they seek to mobilise policy ideas in ways that will be electorally popular. This often involves a second theoretically salient mechanism, *normative framing*. Public policy opinion can be shaped using normative frames, for example when political leaders frame target populations as undeserving of policy assistance (Rose & Baumgartner, 2013; Schneider & Ingram, 1993). In other instances, focusing events or structural changes make possible the use of normative frames that chime with existing public concerns. For instance, in their work on tax policy, Scheve and Stasavage show how mass warfare in WWI led to demands for increased taxation of the wealthy to more fairly distribute the burden of the war effort (Scheve & Stasavage, 2010, 2016).

In our analysis, we show how structural economic change made possible the use of the normative frame of tax fairness to support the idea of market-based taxation. In the digital economy, the case could be made that consumers of goods and services increasingly contribute to creating value for firms that should be taxed. In a broadening of policy contestation beyond tax experts, public facing political leaders mobilised this electorally popular argument to support their unilateral tax measures and establish market-based taxation as a new norm.

## **From consensus to breakdown and back again: a Quarter century of ideational change**

In this section we trace the breakdown and re-establishment of international consensus on the corporate taxation of multinationals. Our historical narrative is divided into three sections corresponding to our theoretical argument. It begins at the end of the twentieth century, documenting the emergence of a 'fairness' rationale for market-based corporate taxation in the context of increasingly prevalent digital business models. We then document a broadening of the policy discussion during which the fairness rationale was used by political leaders to mobilise support for market-based taxation, in response to the disruptive impact of digital business models. We focus on France, an early champion of change, although we later show the same rationale was used to support market-based corporate taxation in Germany, France, Italy, Spain and the UK. Finally, we show how the immobility of consumer markets allowed countries to levy market-based corporate taxes without fear of capital flight. In this way, the previously intractable logic of collective action limiting multinational taxation was redefined as a soluble



policy problem. As unilateral tax measures proliferated, even reluctant powers like the US came to accept market-based taxation as a new international norm.

### ***The emergence of a new rationale for a minority policy idea***

The international tax competition widely held responsible for declining corporate tax rates since the 1980s is structured by a century-long international consensus formed in the immediate interwar years (Picciotto, 1992). Under this consensus, multinational firms are treated as bundles of separate entities, including affiliates that have their own legal personality, and 'Permanent Establishments' (PEs) which are the activities of unincorporated branches in a country. An MNE will not be taxed on the profits earned from economic activities in a country unless its presence there meets the PE threshold. Reflecting the business models prevalent in the early twentieth century, this threshold test requires firms to have a significant physical presence.

The idea that was to shake up this consensus emerged in the mid-1990s, when the transnational corporate tax community started to discuss the tax implications of emerging Information Communications Technologies. Discussions took place in the Committee of Fiscal Affairs (CFA), the OECD's most senior tax body, and at the Ottawa Ministerial Conference on Electronic Commerce in 1998. A Technical Advisory Group (TAG) was set up to examine how existing rules for the taxation of business profits applied in the context of e-commerce. It was within this TAG that what counts as a PE was first called explicitly into question (OECD, 2001). The rise of e-commerce was making it easier for firms to create substantial profits in a country without a significant physical presence. In light of this, did the existing definition of PE require a rethink? To answer this question, participants of the TAG began debating how multinational firms create profits.

One idea was that the consumer market for a firm's goods and services is a factor of production that creates business profits. This justified a fundamental modification of existing tax rules based on physical presence, on the basis that the country providing the market for a company's goods and services should be able to levy taxes on the business profits that its market made possible (OECD, 2001). The idea was rejected outright in the TAG's final report: the 'mere fact' that a country provides a market was not a proper basis for allocating it tax rights, and fundamental modification of existing tax rules was not necessary. The report focused instead on relatively minor clarifications of existing treaty rules, such as whether an internet server could constitute a PE (OECD, 2005).

While allocating corporate tax rights on the basis of the consumer market was dismissed by the OECD at this stage, it persisted as a minority idea within the transnational policy community in the form of proposals for a

'Destination-Based Cash Flow Tax' (DBCFT). The DBCFT proposals emerged among economists in the UK and US in the early 2000s (Auerbach, 2010; Bond & Devereux, 2002), influenced by the reform of cross-border consumption taxes that was underway around the same time (Gelepathis, [forthcoming](#)). Advocates of the DBCFT argued for taxing business profits in the location of firms' consumer markets on the basis that this would be more efficient, eliminating tax competition and profit-shifting because consumers were relatively immobile (Devereux, 2019). The DBCFT gained some political support in the US Congress, where it was championed unsuccessfully by a bipartisan panel on tax reform in 2005, but aside from this it did little to alter the policy alternatives considered by political leaders. It also remained marginal in the transnational tax community: it was championed by economists and had little support from the legal profession, the pinnacle of recognised authority within the community (Christensen, 2021).

By the mid-2000s, then, the idea that consumer markets should play a key role in determining where MNEs pay tax on their profits had been considered and rejected several times. When India and China used their newfound influence within the G20 to make a similar case, they too were given short shrift (Hearson & Prichard, 2018). Yet, even as the international tax community concluded that there was no need for major change, academic studies of the digital economy began to highlight the importance of data and 'free labour' provided by users of digital goods and services (Boutang, 2006; Brynjolfsson, 2011; Lanier, 2013). Users of digital services were no longer just consumers. They also contributed to the value of the firm by generating data or uploading digital content. This meant that digitalisation did not 'merely' allow firms to access consumer markets without physical presence, as the TAG for Business Profits had argued in its 2005 report. It also allowed them to profit from the activities of their users or consumers (Atal, 2020; Srnicek, 2016; Zuboff, 2018). This provided a fairness-based rationale for taxing multinationals in the location of their consumer markets.

### ***A broadening of policy contestation***

France was a forerunner in adopting this fairness-based rationale. Drawing on a report commissioned by his Ministry of Culture, President Sarkozy championed a tax on internet advertising (Ducourtieux et al., 2010). The 'Google Tax', as it became known, formed part of Sarkozy's re-election campaign in 2012. On assuming office in 2012, the new Hollande administration commissioned a report on the taxation of the digital economy. The report set out how the productivity gains achieved through digitalisation had not led to increased tax revenues for large countries (Collin & Colin, 2013). It called for amendment to existing tax rules and a redefinition of PE, so that digitalised firms would 'contribute their fair share'. The report was clear that this

redefinition should be ‘based on the central role played by data and ‘free labour’ provided by users, which are not yet taken into consideration for tax purposes, even though they are at the heart of value creation [...] and common to all the dominant business models of today’s digital economy’ (Collin & Colin, 2013, p. 4). Tensions rumbled on between the Hollande administration and digital firms, with ministerial pronouncements about the ‘unacceptable’ state of Google’s tax affairs, and ultimately unsuccessful attempts by the revenue authority to overcome Google’s circumvention of the PE definition (Johnston, 2014; Schechner, 2014).

The normative rationale set out in the Collin-Colin report chimed with increasing political pressure across rich democracies after the financial crisis. Despite the normally low electoral salience of corporate taxation (Alt et al., 2007), public concern about the fairness of economic policy led to popular anger that corporations were not paying their fair share. This anger focused on firms that had large consumer bases in countries where they paid little tax (Christensen & Hearson, 2019; Mason, 2020).

The ministers of the G20 took action to shape the OECD’s agenda, mandating it to investigate ‘gaps and mismatches in the international tax system that facilitate the shifting of profits by multinational enterprises away from where underlying economic and value creation took place’ (OECD, 2013). The OECD’s response was the Base Erosion and Profit-Shifting (BEPS) project. G20 and OECD countries participated on an equal footing, bringing into the discussion voices from emerging markets who dissented from the existing, western-centric consensus (Grinberg, 2016; Hearson & Prichard, 2018). A *Task Force on the Digital Economy* was created, alongside a 15-point Action Plan that covered both digitalisation and tax avoidance.

As the *Task Force* prepared its report, it became apparent that there was no agreement about whether fundamental change to the distribution of taxing rights was needed. Several OECD members resisted major change, most notably the US, a state with outsize influence over international tax governance (Hakelberg, 2020; Lips, 2019a). Businesses expressed strong opposition to even the contemplation of a reallocation of taxing rights to market jurisdictions. Commenting on the *Task Force’s* 2014 discussion draft, the Business and Industry Advisory Committee to the OECD criticised early proposals ‘to consider tax nexus for enterprises delivering digital goods or services based on the place where those good and services are supplied to.’ The Digital Economy Group, an umbrella body for Silicon valley, argued against options that ‘depart from the fundamental principle of direct tax nexus based on the actual business substance of personnel and assets in the taxing state’ (Herzfeld, 2014).

The final report of the *Task Force* in 2015 therefore largely reaffirmed the existing tax consensus (OECD, 2015). It noted that new phenomena such as the collection of user data, network effects, and the emergence of digital

business models exacerbated base erosion and profit shifting. But in answer to the more fundamental question of how taxing rights should be allocated in the digital age, the report was dismissive of the need to move away from significant physical presence. It simply committed the *Task Force* to continue monitoring developments in the digital economy, with input from an even broader range of countries as part of an *Inclusive Framework* on BEPS.

### ***Definition of a soluble policy problem as unilateral measures proliferate***

Dissatisfied with the conclusions of the 2015 report, and amidst increased salience of corporate tax avoidance following the Luxleaks and Paradise Papers scandals, some countries began to push for change outside the OECD. They appealed to a fairness-based rationale related to value creation in the digital economy. In a joint statement in September 2017, the finance ministers of Germany, France, Italy and Spain announced their commitment ‘to appropriately tax the companies of the digital economy in a way that reflects their genuine activity in the EU’ and warned they would ‘no longer accept that [companies operating in the digital economy] do business in Europe while paying minimal amounts of tax to our treasuries.’ (Le Maire et al., 2017). The UK also shared this view, citing a digitally-driven ‘mismatch between where business profits are taxed and where value is created’ that represented a ‘fundamental challenge to the fairness, sustainability and public acceptability of the corporate tax system (HM Treasury & HM Revenue & Customs, 2018, p. 3).

The European Commission responded by proposing a 3% ‘Digital Tax’ on the revenues of digital companies with significant presence in Europe generated through online advertising, paid subscriptions and the commercial use of personal data. This proposal sat alongside a longer-term plan to introduce significant digital presence as a basis for tax liability, measured by the number of users or the volume of sales (European Commission, 2018).

Given the unanimity requirement in the EU Council for tax matters, divided opinions soon put an end to the Commission’s proposals (Lips, 2019a). According to a statement by the finance ministers of Denmark, Sweden and Finland, there were ‘no reasons to deviate from internationally established principles regarding the allocation of taxing rights for the digital economy’ (Andersson et al., 2018). They expressed scepticism of the need to shift tax rights to the country of the consumer or user, and instead argued for a strengthening of existing international commitments to curb BEPS.

Although EU-level action had faltered, the discussions surrounding the EU’s proposals had highlighted the determination of some countries to pursue fundamental change, and their willingness to act outside the OECD venue if necessary (Lips, 2019a). The threat of unilateral reforms and of costly breakdown in international tax cooperation was credible considering

the immobility of the consumer markets that were being proposed as a basis for taxation. So, by 2018, it was widely expected that in the face of stalled international action more countries would act unilaterally. The OECD published a report that was more equivocal about the need for fundamental change, citing the threat of unilateral measures and urging countries to hold out in favour of an OECD-led solution (OECD, 2018).

Meanwhile, unilateral measures continued to pick up pace (Figure 1, above). Broadly speaking, they took four forms (OECD, 2018). The most common and contentious were DSTs, imposed on the turnover from sales of digital products and services. These spread throughout Europe and further afield. A second category, also levied on gross income, was the expansion of countries' existing withholding tax regimes to capture cross-border payments such as software royalties and online advertising fees. Third, some countries such as Israel and India altered their PE definitions to include a significant digital presence. Finally, specific regimes targeted at the largest digital firms included the Diverted Profits Taxes adopted by the UK and Australia.

In response, the OECD Inclusive Framework made a U-turn. In a policy note issued in early 2019, it announced its intention to consider '*[s]everal proposals ... that would allocate more taxing rights to market or user jurisdictions.*' The policy note recognised that 'the implications of these proposals may reach into fundamental aspects of the current international tax architecture', and that all of the proposals under consideration went 'beyond the limitations on taxing rights determined by reference to a physical presence generally accepted as [a] corner stone of the current rules' (OECD, 2019). This was a striking change from 2013, when the OECD and G20 had agreed not to consider any reforms 'directly aimed at changing the existing international standards on the allocation of taxing rights' (OECD, 2013, p. 11). By 2020, the OECD's position set out in a negotiating blueprint was even clearer. International tax norms should 'allocate a portion of residual profit of in-scope businesses to market/user jurisdictions' even in the absence of a physical presence (OECD, 2020).

Pivotal to the change of position at the OECD was the US. During the original BEPS negotiations, it was the Obama administration that had poured cold water on any re-examination of permanent establishment (Hakelberg, 2020). By 2018, however, US political leaders and businesses came to realise that some reallocation of taxing rights at the OECD was essential to halt the spread of unilateral DSTs, even as the administration threatened trade sanctions against countries that implemented them. The Trump administration's representative in the OECD negotiations stated that, 'we just don't have much alternative to doing our best to push this [the OECD negotiations] through to a successful conclusion ... The alternative, if this crashes and burns, I do think we will be in a world that threatens chaos' (Johnston, 2019).

Rather than resisting the new norm, the US began to mobilise it in its own favour. The Trump administration made a proposal, one of those discussed in the January 2019 OECD policy note, which reallocated taxing rights to market jurisdictions. It did so based on the concept of 'marketing intangibles', which had previously been championed by two other large consumer markets, China and India (Hearson & Prichard, 2018). The US proposal went beyond some others on the table because it applied to all businesses, not just highly digitalised ones, and so would give the US greater taxing rights over foreign firms selling into its large consumer market.

## Discussion and conclusion

The narrative presented above describes the breakdown of a century-old international tax consensus based on firms' physical presence. The norm emerging in its place establishes tax rights based on the value firms create through participation in the user or market jurisdiction. The new norm allows countries to withstand the pressures of tax competition more effectively: consumers and users are immobile factors that can be taxed without fear of them leaving, and tax avoidance is also made harder when countries can claim taxing rights even in the absence of a significant physical presence.

These developments are surprising in light of the well-established power imbalance between states and multinationals that has been roundly expected to worsen in the digital age (Atal, 2020; Bacache-Beauvallet & Bloch, 2018; Thelen & Rahman, 2019; Wren, 2013). Yet our narrative shows that the emergence of digital business models has in fact contributed to redressing the balance of power between states and multinationals. As anticipated by the public policy literature, the idea of market-based taxation was not a new one. It existed as part of a minority discourse on corporate taxation at the turn of the century. At that time, it was easy to dismiss on the basis that consumer markets are not factors of production contributing to the taxable income of a firm. In the digital age however, the case could be made that consumers and users of digital goods and services contribute to creating value for firms, and this provided a new rationale for market-based corporate taxation.

Still, the subsequent establishment of an international consensus around taxing corporations in the market jurisdiction was by no means automatic. Market-based taxation chimed with public concerns in the aftermath of the financial crisis, since it could be framed as a way to ensure that multinationals pay their fair share in the digital age. In a broadening of policy contestation beyond the confines of the OECD-led transnational policy community, the idea of market-based taxation was therefore mobilised by public facing political leaders in countries that stood to gain from a reallocation of tax rights.

While the fairness rationale was invoked prominently by national policy-makers, the efficiency rationale invoked by market-based taxation's original

proponents hardly featured in the policy debate. And yet, it was precisely the immobility of users and consumers that allowed this minority idea to emerge as a new international tax norm. Unilateral actions became feasible where previously they would have had to be coordinated to avoid deterring investment, and this transformed tax competition into a soluble policy problem. The narrative shows how despite persistent opposition from both business representatives and countries whose interests were well-served by the existing arrangements, unilateral measures placed market-based taxation firmly on the international tax policy agenda. In order to avoid further countries adopting uncoordinated measures, the US political establishment came to endorse the idea, and the OECD committed to coordinating reform.

Our explanation therefore emphasises digitalisation's role in dissolving the collective action problem limiting multinational taxation. We identify two mechanisms that link digitalisation with the redefinition of multinational taxation as a soluble policy problem. These mechanisms are theoretically salient, and frequently discussed in public policy scholarship that seeks to explain large-scale change in policy norms.

The first mechanism is the *normative framing* of market-based taxation. Market-based taxes can be levied unilaterally without fear of capital flight, thereby putting pressure on reluctant powers to accept them. The normative framing of market-based taxes as a means to make multinationals 'pay their fair share' was made possible by the rise of digital business models which eroded confidence in the existing tax consensus and implicated consumers and users in value creation. The second mechanism is the *broadening of policy contestation* beyond tax experts to finance ministers and heads of state. These new actors mobilised the minority idea of market-based taxation using the electorally popular normative frame.

Two prominent pressures for change identified in the literature on international corporate taxation might at first glance seem to offer convincing alternative explanations for the emerging tax consensus. One such pressure stems from the disruptive impact of the 2007–08 financial crisis and the austerity politics that followed. Hard economic times and associated electoral demands for redistribution are seen as important drivers of policy change within the CPE literature (Basinger & Hallerberg, 2004; Ganghof, 2006; Swank, 2002). Yet the changes they generate are expected to remain within the confines of fundamental international tax norms. Indeed, the international tax consensus has endured a whole century of financial crises and periods of politicised fiscal austerity. In our argument, the financial crisis contributed to change by allowing political leaders to mobilise the idea of market-based taxation using the normative frame of tax fairness. But our analysis shows that the normative framing of market-based taxation was only made possible by the rise of digital business models.

A second pressure for change arises from the shifting policy positions of countries that are powerful within international tax politics. These countries are notably the US, and – more recently – China, which exerts a growing influence in international tax negotiations. In the IPE literature in particular, great power politics is often considered to be the primary determinant of radical change in global tax governance (Hakelberg, 2020; Lips, 2019a). As an exporter of digital services, China's preferences on the allocation of international corporate tax rights are aligned with those of the US (Dai, 2019). Our analysis has shown that the acquiescence of the US was certainly important, but it was a reaction to the unprecedented wave of unilateral actions by small and medium-sized countries.

At this point some critical reflections are in order relating to the distributional consequences of the changes we have been discussing. In the public debate, the ongoing tax negotiations have been about taxing the rich – clawing back tax revenues from rich multinationals, getting them to pay their fair share. Yet economists have long noted that the extent to which corporate tax increases are progressive depends on the ability of multinationals to pass on their costs to consumers and workers. To what extent then should these corporate tax developments be seen to partially redress the creeping tax regressivity that stems from a forty-year shift in the burden of taxation away from capital towards labour (Saez & Zucman, 2020)?

Since the international politics of corporate taxation are still in flux, and much will depend on the detail of the emerging consensus as it takes shape, the best way to answer this question is by looking at the politics. Despite high-profile warnings by firms like Google and Amazon that their increased costs would ultimately be borne by consumers (Barker, 2020), our narrative has shown strong business opposition to the emerging tax norm. Similarly, despite uncertainty about how much they stand to gain from the new multilateral consensus, several non-OECD countries have already adopted unilateral measures.

In sum, this paper has developed an explanation of the surprising recent reassertion of state power to tax highly mobile multinational firms, building on previous accounts of large-scale change in policy norms. While the precise distributional consequences of these developments are uncertain, our analysis of the politics of taxing multinationals in the digital age suggests that – according to the working expectations of affected parties at least – some progress has been made towards taxing the rich.

## Acknowledgements

We thank our anonymous reviewers, and the editors and participants of this special issue, for helpful comments. Margarita is also grateful to Marco Giani, Chrisanthi Avgerou, and Moraki.



## Biographical note

**Margarita Gelepithis** is a University Lecturer in Public Policy in the Department of Politics and International Studies, University of Cambridge.

**Martin Hearson** is Research Fellow at the Institute of Development Studies, and International Tax Program Lead at the International Centre for Tax and Development.

## Disclosure statement

No potential conflict of interest was reported by the author(s).

## ORCID

Martin Hearson  <http://orcid.org/0000-0002-7108-7372>

## Bibliography

- Ahrens, L., & Bothner, F. (2020). The Big bang: Tax evasion after automatic exchange of information under FATCA and CRS. *New Political Economy*, 25(6), 849–864. <https://doi.org/10.1080/13563467.2019.1639651>
- Alt, J., Preston, I., & Sibieta, L. (2007). The political economy of tax policy.
- Andersson, M., Jensen, K., & Orpo, P. (2018). Nordic states urge U-turn on EU digital tax plans. *EUobserver*. <https://euobserver.com/opinion/141966>.
- Atal, M. R. (2020). The janus faces of Silicon valley. *Review of International Political Economy*, 28(2), 336–350. <https://doi.org/10.1080/09692290.2020.1830830>
- Auerbach, A. J. (2010). *A Modern Corporate tax*. Center for American Progress.
- Bacache-Beauvallet, M., & Bloch, F. (2018). Special issue on taxation in the digital economy: Introduction. *Journal of Public Economic Theory*, 20(5), 5–8. <https://doi.org/10.1111/jpet.12285>
- Barker, A. (2020). Google to pass cost of digital services taxes on to advertisers. *Financial Times*.
- Basinger, S., & Hallerberg, M. (2004). Competing for capital. *American Political Science Review*, 98(2). <https://doi.org/10.1017/S0003055404001133>
- Baumgartner, F., & Jones, B. (2009). *Agendas and Instability in American Politics*. Chicago University Press.
- Béland, D., & Cox, R. H. (2015). Ideas as coalition magnets: Coalition building, policy entrepreneurs, and power relations. *Journal of European Public Policy*, 23(3), 428–445. <https://doi.org/10.1080/13501763.2015.1115533>
- Beramendi, P., & Rueda, D. (2007). Social democracy constrained: Indirect taxation in industrialized democracies. *British Journal of Political Science*, 37(4), 619–641. <https://doi.org/10.1017/S0007123407000348>
- Bond, S. R., & Devereux, M. P. (2002). Cash flow taxes in an open economy.
- Boutang, Y. M. (2006). Transformation de la valeur économique, de son appropriation et de l'impôt. In T. Berns, J. C. Dupont, & M. Xifaras (Eds.), *Philosophie de l'impôt* (pp. 199–226). Bruylant.
- Brunner, F., & Engebretsen, R. (2020). Defenders of the status quo: Making sense of the international discourse on transfer pricing methodologies. *Review of International Political Economy*, 1–29. <https://doi.org/10.1080/09692290.2020.1807386>

- Bryan, D., Rafferty, M., & Wigan, D. (2017). Capital unchained: Finance, intangible assets and the double life of capital in the offshore world. *Review of International Political Economy*, 24(1), 56–86. <https://doi.org/10.1080/09692290.2016.1262446>
- Brynjolfsson, E. (2011). *Race Against the Machine: How the Digital Revolution is Accelerating Innovation, Driving Productivity, and Irreversibly Transforming Employment and the Economy*. Brynjolfsson and McAfee.
- Buttner, T., & Thiemann, M. (2017). Breaking regime stability? The politicization of expertise in the OECD and G20 process of BEPS and the potential transformation of international taxation. *Accounting, Economics, and Law: A Convivium*, 71(1), 757–782. <https://doi.org/10.1515/acl-2016-0069>
- Christensen, R. C. (2021). Elite professionals in transnational tax governance. *Global Networks*, 21(2), 265–293. <https://doi.org/10.1111/glob.12269>
- Christensen, R. C., & Hearson, M. (2019). Review article: The new politics of global tax governance: Taking stock a decade after the financial crisis. *Review of International Political Economy*, 26(5), 1068–1088. <https://doi.org/10.1080/09692290.2019.1625802>
- Christians, A. (2010). Networks, norms and national tax policy. *Washington University Global Studies Law Review*, 9(1), 1–37. <https://doi.org/10.2139/ssrn.1358611>
- Cobb, R., & Elder, C. (1972). *Participation in American Politics: The Dynamics of Agenda Building*. Allyn and Bacon.
- Collin, P., & Colin, N. (2013). Task force on taxation of the digital economy: Report to the Minister for the Economy and Finance.
- Culpepper, P. D. (2015). Structural power and political science in the post-crisis era. *Business Politics*, 2015(17), 391–409. <https://doi.org/10.1515/bap-2015-0031>
- Dai, Y. (2019). China's Surprising Silence on Digital Taxation. *Tax Analysts*.
- Devereux, M. P. (2019). How should business profit be taxed? Some thoughts on conceptual developments during the lifetime of the IFS. *Fiscal Studies*, 40(4), 491–619. <https://doi.org/10.1111/1475-5890.12205>
- Ducourtieux, C., Girard, L., & Herzberg, N. (2010). Nicolas Sarkozy souhaite que Google paye plus d'impôts en France. *Le Monde*. [https://www.lemonde.fr/technologies/article/2010/01/08/nicolas-sarkozy-souhaite-que-google-paye-plus-d-impots-en-france\\_1289051\\_651865.html](https://www.lemonde.fr/technologies/article/2010/01/08/nicolas-sarkozy-souhaite-que-google-paye-plus-d-impots-en-france_1289051_651865.html).
- European Commission. (2018). *Impact Assessment accompanying the document Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence*.
- Ganghof. (2006). Tax mixes and the size of the welfare state: Causal mechanisms and policy implications. *Journal of European Social Policy*, 16(4), 360–373. <https://doi.org/10.1177/0958928706068274>
- Garrett, G. (1998). *Partisan Politics in the Global Economy*. CUP.
- Gelepathis, M. (Forthcoming). The Politics of Tax policy in the digital Age. In M. Busemeyer, A. Kemmerling, P. Marx, & K. V. Kersbergen (Eds.), *Digitalization and the Welfare State* (pp. xx–xx). OUP.
- Genschel, P. (1999). Globalization, Tax competition and the Welfare state. *Politics and Society*, 30(2), 245–275. <https://doi.org/10.1177/0032329202030002003>
- Genschel, P., & Rixen, T. (2015). Settling and unsettling the transnational legal order. In T. C. Halliday, & G. Shaffer (Eds.), *Transnational Legal Orders* (pp. 154–186). CUP.
- Greer, S. (2015). John w. Kingdon, agendas, alternatives and public policies. In M. Lodge, E. C. Page, & S. J. Balla (Eds.), *The Oxford Handbook of Classics in Public Policy and Administration* (pp. 417–429). OUP.

- Grinberg, I. (2016). The New international Tax diplomacy. *The Georgetown Law Journal*, 104(5), 1137–1196. <https://ssrn.com/abstract=2995638>
- Hakelberg, L. (2020). *The Hypocritical Hegemon: How the United States Shapes Global Rules Against tax Evasion and Avoidance*. Cornell University Press.
- Hakelberg, L., & Rixen, T. (2020). Is neoliberalism still spreading? The impact of international cooperation on capital taxation. *Review of International Political Economy*, 28(5), 1142–1168. <https://doi.org/10.1080/09692290.2020.1752769>
- Hall, P. (1993). Policy paradigms, social learning, and the state: The case of economic policymaking in Britain. *Comparative Politics*, 25(3), 275–296. <https://doi.org/10.2307/422246>
- Hall, P. A., & Soskice, D. (eds.). (2001). *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*. OUP.
- Hays, J. C. (2003). Globalization and capital taxation in consensus and majoritarian democracies. *World Politics*, 56(4), 79–113. <https://doi.org/10.1353/wp.2004.0004>
- Hearson, M. (2021). *Imposing Standards: The North-South Dimension to Global Tax Politics*. Cornell University Press.
- Hearson, M., & Prichard, W. (2018). China's challenge to international tax rules and the implications for global economic governance. *International Affairs*, 94(6), 1287–1307. <https://doi.org/10.1093/ia/iiy189>
- Herzfeld, M. (2014). The BEPS Digital Economy Draft – Struggling for Consensus. *Tax Notes International*.
- HM Treasury & HM Revenue & Customs. (2018) *Digital Services Tax: Consultation*. London: Crown.
- Iversen, T., & Soskice, D. (2019). *Democracy and Prosperity: Reinventing Capitalism Through a Turbulent Century*. Princeton University Press.
- Johnston, S. S. (2014). News Analysis: Chasing Google – The Global Struggle to Tax E-Commerce. *Tax Notes International*.
- Johnston, S. S. (2019). U.S. Senators Warn EU Digital Taxes Undercut OECD Progress. *Tax Notes International*.
- Kingdon, J. W. (2003). *Agendas, Alternatives and Public Policies*. HarperCollins.
- Lanier, J. (2013). *Who Owns The Future?* Penguin.
- Le Maire, B., Schäuble, W., Padoan, P., & De Guindos, L. (2017). *Political statement: joint initiative on the taxation of companies operating in the digital economy*.
- Lindblom, C. (1980). *Politics and Markets: The World's Political Economic Systems*. Basic Books.
- Lips, W. (2019a). The EU Commission's digital tax proposals and its cross-platform impact in the EU and the OECD. *Journal of European Integration*, 975–990. <https://doi.org/10.1080/07036337.2019.1705800>
- Lips, W. (2019b). Great powers in global tax governance: A comparison of the US role in the CRS and BEPS. *Globalizations*, 16(1), 104–119. <https://doi.org/10.1080/14747731.2018.1496558>
- Martin, C. J. (2015). Labour market coordination and the evolution of tax regimes. *Socio-Economic Review*, 13(1), 33–54. <https://doi.org/10.1093/ser/mwu018>
- Mason, R. (2020). The transformation of international tax. *American Journal of International Law*, 114(3), 353–402. <https://doi.org/10.1017/ajil.2020.33>
- McLoughlin, J. (2019). Digital Services Tax Approach Would Kill OECD Consensus. *Tax Notes International*.
- Murphy-Gregory, H., Elbra, A., Mikler, J., & Johnson, L. (2020). The Australian campaign against corporate tax avoidance. *Australian Journal of Political Science*, 55(4), 399–415. <https://doi.org/10.1080/10361146.2020.1774508>

- OECD. (2001). *Attribution of Profit to a Permanent Establishment Involved in Electronic Commerce Transactions*.
- OECD. (2005). *Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-commerce? Final Report*.
- OECD. (2013). *Action Plan on Base Erosion and Profit Shifting*.
- OECD. (2015). *Addressing the Tax Challenges of the Digital Economy: Action 1, 2015 Final Report*.
- OECD. (2018). *Tax Challenges Arising From Digitalisation: Interim Report*.
- OECD. (2019). *Addressing the Tax Challenges of the Digital Economy - Policy Note*.
- OECD. (2020). *Tax Challenges Arising from Digitalisation - Report on Pillar One Blueprint*.
- Picciotto, S. (1992). *International Business Taxation: A Study in the Internationalization of Business Regulation*. Quorum Books.
- Rose, M., & Baumgartner, F. R. (2013). Framing the poor: Media coverage and US poverty policy, 1960–2008. *Policy Studies Journal*, 41(1), 22–53. <https://doi.org/10.1111/psj.12001>
- Saez, E., & Zucman, G. (2020). *The Triumph of Injustice. How the Rich Dodge Taxes and How to Make Them pay*. Norton and Co.
- Schechner, B. (2014). Google's Tax Setup Faces French Challenge. *Wall Street Journal*. <https://www.wsj.com/articles/googles-tax-setup-faces-french-challenge-1412790355>.
- Scheve, K., & Stasavage, D. (2010). The conscription of wealth: Mass warfare and the demand for progressive taxation. *International Organization*, 64(4), 529–561. <https://doi.org/10.1017/S0020818310000226>
- Scheve, K., & Stasavage, D. (2016). *Taxing the Rich. A History of Fiscal Fairness in the United States and Europe*. Princeton University Press.
- Schmidt, V. (2002). *The Futures of European Capitalism*. OUP.
- Schneider, A., & Ingram, H. (1993). Social construction of target populations: Implications for politics and policy. *American Political Science Review*, 87(2), 334–347. <https://doi.org/10.2307/2939044>
- Seabrooke, L., & Wigan, D. (2016). Powering ideas through expertise: Professionals in global tax battles. *Journal of European Public Policy*, 23(3), 357–374. <https://doi.org/10.1080/13501763.2015.1115536>
- Smyth, J., & Giles, C. (2021). OECD's incoming chief confident of global deal on taxing multinationals. *Financial Times*. <https://www.ft.com/content/6adde5c7-ae73-417c-ae42-0972e07d4982>.
- Srnicek, N. (2016). *Platform Capitalism*. Polity Press.
- Steinmo, S. (1989). Political institutions and Tax policy in the unites states, Sweden and britain. *World Politics*, 41(4), 500–535. <https://doi.org/10.2307/2010528>
- Stone, D. (1989). Causal stories and the formation of policy agendas. *Political Science Quarterly*, 104(2), 281–300. <https://doi.org/10.2307/2151585>
- Strange, S. (1996). *The Retreat of the State: The Diffusion of Power in the World Economy*. CUP.
- Swank, D. (2002). The new political economy of taxation in advanced capitalist democracies. *AJPS*, 46(3), 642–655. <https://doi.org/10.2307/3088405>
- Swank, D. (2016). Taxing choices: International competition, domestic institutions and the transformation of corporate tax policy. *Journal of European Public Policy*, 23(4), 571–603. <https://doi.org/10.1080/13501763.2015.1053511>
- Thelen, K., & Rahman, K. S. (2019). The rise of the Platform business model and the transfromation of twenty-first-century capitalism. *Politics and Society*, 47(2), 177–204. <https://doi.org/10.1177/0032329219838932>

- Wildavsky, A. (1979). *Speaking Truth to Power. The Art and Craft of Policy Analysis*. Transaction Publishers.
- Wren, A. (2013). Introduction: The Political Economy of post-industrial societies. In A. Wren (Ed.), *The Political Economy of the Service Transition* (pp. 1–63). OUP.
- Ylönen, M., & Teivainen, T. (2017). Politics of intra-firm trade: Corporate price planning and the double role of the arm's length principle. *New Political Economy*, 23(44), 441–457. <https://doi.org/10.1080/13563467.2017.1371124>
- Zuboff, S. (2018). *The age of Surveillance Capitalism: the Fight for a Human Future at the new Frontier of Power*. PublicAffairs.