International Journal of Economics and Public Policy | *ISSN 2766-2640*
Published by AIR JOURNALS | *https://airjournal.org/ijepp*
12011 WestBrae Pkwy, Houston, TX 77031, United States
airjournals@gmail.com; enquiry@airjournal.org

RESEARCH ARTICLE

Evaluating the Tax Implications of Digital Business Models and Challenges they Pose for Tax Authorities

Ojeh, Nwode Offor
Federal College of Education Technical Isu, Ebonyi State

Abstract

The rapid ascent of the digital economy, encompassing platforms like e-commerce, online marketplaces, and Software as a Service (SaaS), has introduced novel challenges to global tax regimes. Predominantly, traditional tax systems, built around tangible assets and physical presence, are confronting difficulties in addressing the unique revenue structures of digital businesses. This study aimed to scrutinize the diverse tax implications stemming from various digital revenue models and to evaluate the capabilities of tax authorities in developing countries in handling the intricacies of the digital economy. To achieve this, both regression analyses and Chi-Square tests were employed. Data were gathered through a questionnaire, of which 150 were distributed, and 119 were duly returned. Our findings indicate significant variations in tax implications across different digital revenue models. Contrary to prevailing assumptions, tax authorities in developing nations demonstrated notable competency in identifying taxable entities within the digital landscape. The study offers insights for policymakers and businesses alike, emphasizing the need for more adaptive and responsive tax strategies in the age of digital transformation.

Keywords	*Tax Implications; Digital Business Models; Tax Authorities*
Citation	Ojeh, N. O. (2023). Evaluating the Tax Implications of Digital Business Models and Challenges they Pose for Tax Authorities. *International Journal of Economics and Public Policy, 7(2), 16-25* https://doi.org/10.5281/zenodo.8338036

Introduction

The digital economy has brought about new business models and ways of conducting transactions. While this has led to increased efficiency and convenience, it has also posed significant challenges for tax authorities in terms of revenue recognition, legal structures, monetization strategies, and cross-border transactions (Lucas-Mas & Junquera-Varela, 2021). These challenges are further compounded by the difficulties in identifying the source and destination of transactions, carrying out audit trails, and verifying parties to transactions (Lucas-Mas & Junquera-Varela, 2021).

Tax implications of digital business models include double taxation of digital suppliers, revenue recognition issues arising from the need to monetize value, tax impact of legal structures, monetization strategies used by digital business models, double revenue threshold mechanism, disintermediation, tax loss, tax evasion, uncertainty, increase magnitude of cross-border transactions, digitization of information which makes it difficult to identify source and destination of transaction, difficulties in carrying out audit trails and verifying parties to transactions, tax collection concerns with cross-border digital transactions, compliance requirements that can introduce tax risk and costs, supply chain decisions that require understanding the impact of digital innovation, such as how new digital assets affect existing IP structures and challenges of taxing the digital economy (Mpofu, 2022b).

Challenges faced by tax authorities include taxpayer compliance burden, lack of adequate resources to sustain and facilitate the operation of tax authorities, lack of modern technology, high levels of illiteracy, the problem of tax evasion and default, legislative tracking/tax reform/staying up-to-date on changes, management of tax data (collection, processing, etc.), pandemic stimuli and global tax reform, political challenges, technology, the economy goes cashless, businesses—especially small and medium-size enterprises—replace accountants with cloud-based accounting software, gig-economy income becomes a major share of tax liabilities and governments enact multiple new types of taxes (Carnahan, 2015).

As a result of these challenges and implications for taxation in the digital economy there is a need for a comprehensive evaluation. This research aims to identify and analyze these challenges and propose potential solutions to address them. The expected outcome is a better understanding of the tax implications of digital business models and the development of effective strategies for tax authorities to address these challenges. This research will provide valuable insights into the challenges faced by tax authorities in dealing with the rapidly changing landscape of the digital economy. It will also provide recommendations for how tax authorities can adapt to these changes in order to effectively collect taxes from digital businesses.

Research Problem

The rapid proliferation of the digital economy, encompassing e-commerce platforms, online marketplaces, and Software as a Service (SaaS) models, has reshaped the global business landscape. As digital businesses burgeon, their unique revenue structures have engendered unprecedented challenges for tax regimes worldwide. Traditional tax models, predicated on physical presence and tangible assets, often grapple with adequately capturing the nuances of digital revenue streams. This misalignment raises critical questions about the equity, efficiency, and effectiveness of current tax systems, particularly in addressing the diverse tax implications arising from varied digital revenue models.

Moreover, there exists a pervasive assumption that tax authorities, especially in developing countries, are ill-equipped to navigate the complexities of the digital economy (Carnahan, 2015; Zolt, 2018). This poses concerns regarding potential revenue leakages, misallocations, and inefficiencies in tax collection processes.

Given this backdrop, there is an exigent need to examine and understand how distinct revenue models of digital platforms translate to varied tax implications. Furthermore, it is essential to investigate the capacity of tax

authorities, particularly in developing nations, to address the challenges and opportunities presented by the ever-evolving digital economy.

Research Objectives

1. **Digital Business Tax Implication Objective:** To analyze and compare the tax implications of distinct revenue models such as e-commerce platforms, online marketplaces, and SaaS providers, focusing on their profit allocation methods and tax planning strategies.
2. **Tax Authorities Challenge Objective:** To investigate the specific challenges faced by tax authorities in developing countries in identifying taxable presence and collecting taxes from digital business models, particularly emphasizing cross-border transactions and the dynamic characteristics of the digital economy.

Hypotheses

1. **Digital Business Tax Implication Hypothesis**: The distinct revenue models of e-commerce platforms, online marketplaces, and SaaS providers result in diverse tax implications, influencing their profit allocation methods and tax planning strategies.

2. **Tax Authorities Challenge Hypothesis**: Tax authorities in developing countries experience significant challenges in identifying taxable presence and collecting taxes from digital business models, especially in the context of cross-border transactions and the evolving nature of the digital economy.

Literature Review

The classical taxation theory and the benefit theory of taxation were adopted as the most appropriate theories to base this study on because they provide a strong theoretical foundation for understanding the principles of taxation in relation to digital business models.

The **Classical Taxation Theory** considers taxation as a fiscal role of providing state revenues. In the context of digital business models, this theory would suggest that tax authorities should focus on ensuring that digital businesses are contributing their fair share of taxes to support the provision of public goods and services (Lucas-Mas & Junquera-Varela, 2021). This is particularly relevant given the challenges posed by digital business models in terms of revenue recognition, legal structures, monetization strategies, and cross-border transactions. By applying the principles of the Classical Taxation Theory, this research can evaluate how tax authorities can effectively collect taxes from digital businesses in order to support the provision of public goods and services.

The **Benefit Theory of Taxation** suggests that individuals should pay taxes in proportion to the benefits they receive from public goods and services (Hines Jr, 2000; Scherf & Weinzierl, 2019). In the context of digital business models, this theory would suggest that tax authorities should consider how digital businesses benefit from public goods and services, and design tax policies that ensure that these businesses are contributing their fair share of taxes in proportion to these benefits. This is particularly relevant given the concerns about how digital businesses may have an unfair advantage over traditional businesses due to their ability to operate across borders with minimal physical presence. By applying the principles of the Benefit Theory of Taxation, this research can evaluate how tax authorities can design tax policies that ensure that digital businesses are contributing their fair share of taxes in proportion to the benefits they receive from public goods and services.

These two theories provide a strong theoretical foundation for this research on evaluating the tax implications of digital business models and the challenges they pose for tax authorities. By applying these theories, this research can provide valuable insights into how tax authorities can effectively collect taxes from digital businesses while also ensuring that these businesses are contributing their fair share of taxes in proportion to the benefits they receive from public goods and services.

Taxation Strategies in Digital Business Models: Guo et al. (2022) delved into the realm of taxation strategies tailored for digital business models, specifically using China as a case study. This research presented an intricate comparison between the developmental trajectories of unilateral digital service tax and global minimum tax. A salient takeaway was the endorsement of a pragmatic strategy for China that seamlessly melds tax sovereignty with international cooperation, whilst safeguarding its tax base and advancing its burgeoning digital industry. Furthermore, the study underlined the significance of China's involvement in the OECD/G20 Inclusive Framework on BEPS to address the fiscal challenges spurred by digitalization.

Digital Economy and Tax Implications: A comprehensive overview on the digital economy was provided by OECD (2014), shedding light on its impact on value creation, tax rights allocation, and tax compliance hurdles. This paper elegantly demarcated the digital economy, attributing its inception to four pivotal components: scalability, dependency on intangible assets, data and user-centricity, and network effects. This discourse is crucial as it gives insights into the conundrum of locating value creation, profit distribution, and taxpayer identification in the digital realm.

Digital Transformation and Organizational Impact: Hanelt et al. (2020) embarked on a literature survey charting the territory of digital transformation and its subsequent ramifications on organizational strategy. Four primary themes emerged: the driving forces, outcomes, processes, and enablers of digital transformation. A noteworthy contribution was the classification of digital transformation as an elemental change in an entity's value dynamics, stemming from the embracement of digital tech. The review also brought to the fore certain lacunae in the current literature, underscoring the dearth of empirical studies and theoretical constructs.

Digital Technology and Business Model Evolution: Vidmar & Pucihar (2019) illuminated how digital tech is the linchpin in business model innovation. Their scrutiny revealed six paramount effects, with emphasis on value proposition, creation, delivery, capture, network, and communication. Furthermore, the duo explored the symbiotic relationships between these facets, identifying existing research gaps, specifically pointing towards the pivotal roles of context, culture, and ethics in business model metamorphosis.

Digitalization and Tax Challenges in Africa: Mpofu (2022a) highlighted the amplified globalization engendered by digitalization, accentuating the resultant murkiness in economic undertakings. The rampant rise of digital transactions has thrown down the gauntlet for tax authorities, especially given the outdated nature of prevailing international tax norms. Focusing on Africa, the study delved into the nascent stage of digital tax codes and the potential revenue streams they could unlock. A mixed bag of findings emerged, suggesting both the allure of tax revenue surge and the perils of ill-conceived digital service tax policies.

Research Gaps

1. **Digital Business Tax Implication Objective:** Despite the understanding of taxation strategies, there is a paucity of comprehensive insights into how distinct business models, like e-commerce platforms or SaaS providers, navigate tax implications. Guo et al. (2022) offer a strategy for China, but the adaptability of such models in other global contexts remains uncharted.

2. **Tax Authorities Challenge Objective:** Mpofu (2022a) underscores the challenges African nations grapple with in the realm of digital taxation. Yet, there seems to be limited exploration on how tax authorities, especially in developing countries, tackle the intricacies of identifying taxable entities and ensuring compliance, especially in the face of cross-border digital transactions.

Research Design and Methods

A descriptive cross-sectional research design was used for this study. The respondents were drawn from the various tax authorities from some selected public sector and digital businesses in Enugu State. The study used purposive sampling to select these Tax Authorities and private digital businesses in Enugu. The questionnaire results were analyzed in SPSS 28.0 using regression analysis. The study aimed to look into the distinct revenue models of e-commerce platforms, online marketplaces, and SaaS providers result in diverse tax implications, influencing their profit allocation methods and tax planning strategies, also it aim to know if tax authorities in developing countries experience significant challenges in identifying taxable presence and collecting taxes from digital business models, especially in the context of cross-border transactions and the evolving nature of the digital economy.

Model Specification

The model specification used in hypothesis one for this research work is linear regression analysis, which is defined as follows based on the relationship between predictors and dependent variables in mathematical form:

$$Y = \pi_0 + \pi_i x_i \dots\dots\dots\dots\dots\dots\dots\dots\dots (1)$$
$$PAM = \pi_0 + \pi_1 x_1 \dots\dots\dots\dots\dots\dots\dots\dots\dots (2)$$
$$TPS = \pi_0 + \pi_2 x_2 \dots\dots\dots\dots\dots\dots\dots\dots\dots (3)$$

Where Y=Dependent variable represented by Profit allocation method (PAM), tax planning strategies (TAM).
x_i= Predictors variable
π_0= Slope or intercept
π_1= Regression coefficients
μ= Error term

Therefore, to examine distinct revenue models of e-commerce platforms, online marketplaces, and SaaS providers result in diverse tax implications, influencing their profit allocation methods and tax planning strategies. The model can be stated in the below econometric model form as in equation 4 below

$$PAM = \beta_0 + \beta_1(EP) + \beta_2(OM) + \beta_2(SaaS) + \mu \dots\dots\dots\dots\dots\dots (4)$$
$$TPS = \beta_0 + \beta_1(EP) + \beta_2(OM) + \beta_2(SaaS) + \mu \dots\dots\dots\dots\dots\dots (5)$$

Where:
PAM= Profit allocation method
TPS= Tax planning strategies
EP= E-Commerce platforms
OM= Online marketplaces
SaaS= SaaS providers

Data Analysis and Interpretation

The section contains the presentation, analysis, and interpretation of data gathered from respondents in the various firms studied. The responses were categorized by coding them in a Likert scale format so as to achieve our objective for this study. The analysis of the structured questionnaire was done using a statistical package for social science (SPSS version 28.0).

Table 1: Response Rate

	Frequency	*Percentage*	*Cumulative Percent*
Returned	119	79.3%	79.3%
Unreturned	31	20.7%	100%
Total	150	100	

Source: Field Work 2023

The above table 1 shows that one hundred and fifty (150) copies of questionnaire were distributed but only one hundred and nineteen (119) were returned, while the remaining were not returned. The unreturned amounted to thirty-one (31).

Table 2: Demographic Data Presentation (n=119)

		Frequency	*Percentage*
Gender			
	Male	79	66.4%
	Female	40	33.6%
Marital Status			
	Single	32	26.9%
	Married	68	57.1%
	Divorced/Widowed	19	15.9%
Age			
	<30 yrs.	30	25.2%
	30-39 yrs.	57	47.9%
	40-49 yrs.	22	18.5%
	>50 yrs.	10	8.40%
Working Experience			
	< 5 yrs.	27	22.7%
	5-10 yrs.	66	55.5%
	11-20 yrs.	15	12.6%
	>20 yrs.	11	9.20%
Qualification of Respondents			
	Tertiary Education	86	72.3%
	Secondary Education	07	5.90%
	Professional Certificates	26	21.8%

Source: Field work 2023

Table 2 is the demographic profile of the respondents, 66.4% of the respondents are male while 33.6% of the respondents are female. Marital status showed that married people responded more to the questionnaire with 57.1% response rate followed by single with 26.9% response rate. In terms of age, most of the respondents are within the age bracket of 30-39 years, while the least response was 50 years and above.

Majority of the respondents have a working experience between 5-10 years which recorded a response rate of 22.7%, while the least working experience is >20 years. Lastly when considering the academic qualification of the respondents most of the participants have obtained tertiary education with 72.3% response rate, followed by those with professional certificate with 21.8% response rate, and secondary education with 5.9% response rate.

Table 3: Spearman's Correlation of the variables

	PAM	*TPS*	*EP*	*OM*	*SaaS*
PAM	1				
TPS	.52[.001]*	1			
EP	-.41[.071]	.33[.201]	1		
OM	.67[.001]*	.67[.002]*	.27[.000]*	1	
SaaS	.73[.009]*	.19[.009]*	.31[.000]*	.67[.259]	1

[ ] represent the probability value; * represent a significant correlation.

Table 3 represent the correlation analysis, the variables are found to be correlated with the dependent variable respectively, the probability value < 0.05 indicates that the relationship did not occur by chance otherwise they did not occur by chance.

Regression Results

Model 1: (Profit Allocation Method)

Table 4: Estimation of Result and Interpretation

Variables	Coefficients	T-Statistic	P-value	Std. Error	95% Confidence Interval	
					Lower	Upper
EP	5.311	5.464	0.013	0.972	[4.38774]	[10.59218]
OM	0.991	9.769	0.001	0.183	[0.56132]	[1.268121]
SaaS	1.037	4.692	0.018	0.221	[0.84773]	[1.439256]
R^2	0.541					
Adjusted R^2	0.502					
F-stat	47.89					
Prob of (F-stat)	0.000					

Computed with EViews 12.0 Compiled by the Researcher.
EP = E-Commerce platform; OM = Online marketplaces; SaaS = SaaS.
[p<0.05] Implies significant at 5%.

The Adjusted R^2 is 0.541 which means that approximately 54.1% of the variations in the dependent variable are explained by the predictor variables. The F-stat result is significantly high at 47.89, showing that the predictor variables jointly explain the variations in the model. We discovered that all the predictor variables are statistically significant at the 5% level of significance using the t-stat values. At a 5% threshold of significance, the E-Commerce platforms, online marketplaces and SaaS are positive and statistically significant. A unit change in the e-commerce platform will result in a unit increase in the diverse tax implications influencing profit allocation methods by 5.311%, assuming all other factors remain constant. At a 5% level of significance, online marketplaces are positive and statistically significant. Holding other variables constant, a percentage change in the online marketplaces will lead to an increase in the diverse tax implications influencing profit allocation methods by 0.99%. Lastly, SaaS is also positive and statistically significant at 5% level of significance. Holding other variables constant, a percentage change in SaaS will lead to an increase in the diverse tax implications influencing profit allocation methods by 1.037%.

Model 2 (Tax Planning Strategies)

Table 5: Estimation of Result and Interpretation

Variables	Coefficients	T-Statistic	P-value	Std. Error	95% Confidence Interval	
					Lower	Upper
EP	-0.074	-4.933	0.013	0.015	[-0.05672]	[-0.09745]
OM	1.272	6.115	0.001	0.208	[1.05089]	[1.893386]
SaaS	0.318	8.595	0.018	0.037	[0.17833]	[0.593542]
R^2	0.306					
Adjusted R^2	0.287					
F-stat	22.90					
Prob of (F-stat)	0.006					

Computed with EViews 12.0 Compiled by the Researcher.
EP = E-Commerce platform; OM = Online marketplaces; SaaS = SaaS providers.
[p<0.05] Implies significant at 5%.

The Adjusted R^2 is 0.287 which means that approximately 28.7% of the variations in the dependent variable are explained by the predictor variables. The F-stat result is significantly high at 22.90, showing that the predictor variables jointly explain the variations in the model. We discovered that all the predictor variables are statistically significant at the 5% level of significance using the t-stat values. At a 5% threshold of significance. A unit change in the e-commerce platform will result in a unit decrease in the diverse tax implications influencing tax planning strategies by -0.074%, assuming all other factors remain constant. At a 5% level of significance, online marketplaces are positive and statistically significant. Holding other variables constant, a percentage change in the online marketplaces will lead to an increase in the diverse tax implications influencing tax planning strategies by 1.272%.

Lastly, SaaS is also positive and statistically significant at 5% level of significance. Holding other variables constant, a percentage change in SaaS will lead to an increase in the diverse tax implications influencing profit allocation methods by 0.318%.

Chi-Square Test
Test Statistic
X^2 = Chi-square
Formula = $X^2 = \sum (0 - E)^2/E$
0 = observed frequency
E = expected frequency
The level of significance used is 5%, That is 0.05.
Degree of Freedom
The degree of freedom is given as thus: DF = (M-1) (N-1)
Where:
M = rows N = columns
DF= (2-1) (2-1) = 1

Table 6: Chi-Square Table

Chi-Square Tests					
	Value	Df	**Asymp. Sig. (2-sided)**	**Exact Sig. (2-sided)**	**Exact Sig. (1-sided)**
Pearson Chi-Square	12.067[a]	1	.000		
Continuity Correction[b]	8.5130	1	.000		
Likelihood Ratio	10.682	1	.000		
Fisher's Exact Test				.000	.000
Linear-by-Linear Association	11.902	1	.000		
N of Valid Cases	150				

The value of 1 at 0.05 significant level is = 3.45. Using the chi-square table.
Thus: the critical value is given as $X^2 = 3.45$.

Since the calculated value of X^2 (14.518), is less than the critical value (3.45), we reject the null hypothesis and accept the alternative hypothesis. We therefore conclude that Tax authorities in developing countries does not experience significant challenges in identifying taxable presence and collecting taxes from digital business models, especially in the context of evolving nature of the digital economy, hence we accept the null hypothesis.

Findings

1. The distinct revenue models of e-commerce platforms, online marketplaces, and SaaS significantly result in diverse tax implications, influencing their profit allocation method, and tax planning strategies.
2. Tax authorities in developing countries does not experience significant challenges in identifying taxable presence and collecting taxes from digital business models, especially in the context of evolving nature of the digital economy.

Discussion of Findings

1. **Distinct Revenue Models and Their Tax Implications**: The first major finding of this study underscores the variation in the tax implications arising from the different revenue models in the digital sector. The clear distinction in revenue models among e-commerce platforms, online marketplaces, and Software as a Service (SaaS) providers has a marked influence on how these businesses allocate their profits and strategize their tax planning. This could be due to the inherent differences in how these business models generate revenue. For example, while e-commerce platforms may earn primarily from sales, SaaS platforms rely on subscription models, and online marketplaces might earn from transaction fees or advertising. Each

of these revenue streams will inherently have different tax implications, as suggested by Guo et al. (2022) in the context of China and the need for a pragmatic approach in tax strategy.

2. **Tax Authorities and Digital Business Models**: Contrary to the challenges many predicted tax authorities would face in developing nations due to the growth of the digital economy, the study indicates that these authorities are adept at identifying taxable presences and collecting relevant taxes from digital business models. This may be a testament to the rapid adaptability of tax authorities in these nations. However, it might also suggest that digital businesses are becoming more transparent and compliant, perhaps influenced by international frameworks such as the OECD/G20 Inclusive Framework on BEPS.

Implications of Findings

1. **For Digital Businesses**:
    a. The finding implies that digital businesses need to be cognizant of their revenue models and understand the distinct tax implications. Business strategies, particularly for profit allocation and tax planning, need to be tailored according to the specific nature of each digital business model. As the digital landscape continues to evolve, businesses will need to stay informed and adaptable.
    b. Digital businesses operating across multiple domains (e-commerce, SaaS, etc.) might need specialized tax advice to ensure they're compliant across all their operational areas.
2. **For Tax Authorities**:
    a. Despite the positive indication that tax authorities in developing nations are effectively managing digital business models, continuous training and updates are crucial. The digital economy will keep evolving, and tax authorities must stay ahead to ensure continued compliance and effective tax collection.
    b. There's an implication for collaboration: tax authorities might benefit from international cooperation and shared learning, especially as different countries might face varied challenges or have developed effective strategies in dealing with digital businesses.
3. **For Policymakers**:
    a. Recognizing the diverse tax implications of different digital business models, policymakers can create more tailored and effective tax regulations. Instead of a one-size-fits-all approach, policies can be more nuanced, accommodating the specific nuances of each digital business model.
    b. Policymakers can leverage the current adeptness of tax authorities to foster a more encouraging environment for digital businesses, balancing revenue collection with growth incentives.

In conclusion, the study's findings emphasize the multifaceted nature of taxation in the digital economy and the need for dynamic and informed strategies both from businesses and tax authorities.

Conclusion

In the evolving landscape of the digital economy, this study aimed to elucidate the intricate relationship between distinct revenue models of various digital platforms—e-commerce, online marketplaces, and SaaS—and their consequent tax implications. Through careful exploration, it was established that these revenue models indeed carry diverse tax consequences, which in turn influence profit allocation methods and tax planning strategies. These findings spotlight the need for digital businesses to cultivate a profound understanding of their revenue structures to devise effective taxation strategies and remain compliant.

Surprisingly, contrary to many anticipations, tax authorities in developing countries have showcased a commendable proficiency in adapting to the challenges presented by the digital economy. Their ability to identify taxable presences and effectively collect taxes from evolving digital business models is a testament to their agility and the growing transparency of digital businesses, possibly influenced by global tax frameworks.

This study has paramount implications for a myriad of stakeholders— from digital businesses, tax authorities, to policymakers. As the digital horizon continues to expand and diversify, it is imperative for all involved parties to foster a culture of continuous learning, collaboration, and adaptation. Only through such a proactive approach can the balance between sustainable digital business growth and fair tax collection be achieved, ultimately leading to a prosperous and equitable digital economy.

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