Why the U.N. Must Put AI and Data on the Tax Agenda

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In this article, Latif argues that the United Nations ad hoc committee on international tax cooperation must address the structural aspects of artificial intelligence (AI) in its work to create a more inclusive, equitable, and effective global tax system in light of the complexities of the AI-driven economy, which include issues related to data, intellectual property, and the fragmentation of the AI value chain.

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Introduction

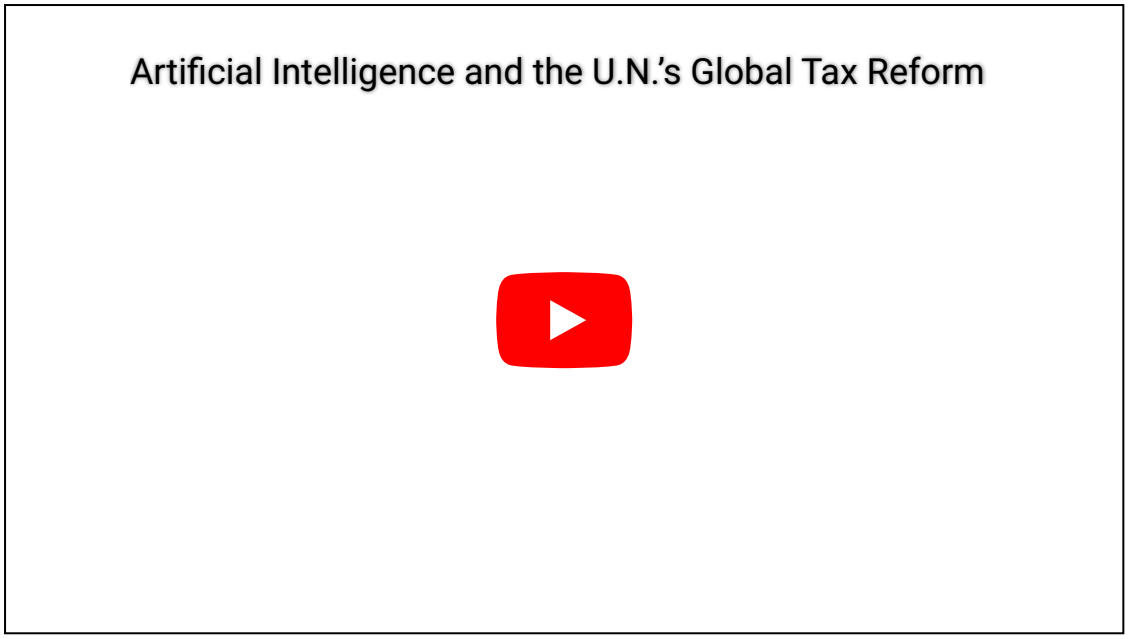
The international tax landscape has undergone significant changes in recent years, with the rapid advancement of technology and the globalization of the economy presenting new challenges and opportunities for countries.[1] In response to these developments, the United Nations has taken a celebrated step by establishing an ad hoc committee on international tax cooperation to address the pressing need for a more inclusive, equitable, and effective global tax system.[2] As the committee embarks on its crucial work, it is imperative that it considers the structural aspects of artificial intelligence (AI) as an integral

part of the tax discourse, recognizing the profound impact that AI has on the way businesses operate, value is created, and profits are allocated across borders.

AI has fundamentally transformed the nature of business operations, enabling companies to automate processes, improve efficiency, and make data-driven decisions. However, this transformation has also led to the emergence of new business models that challenge traditional notions of value creation and profit allocation. For instance, AI-powered platforms can generate significant value through the collection, processing, and analysis of user data, even if they have no physical presence in the countries where their users are located. This has led to a decoupling of value creation from physical presence, making it difficult for countries to assert their taxing rights over the profits generated by these platforms.

The development and deployment of AI systems often involve complex global value chains, with different stages of the process, such as research and development, data collection, and algorithm training, taking place in different jurisdictions.[3] This fragmentation of the AI value chain makes it challenging for tax authorities to determine where value is created and how profits should be allocated for taxation purposes. As a result, there is a risk that a significant portion of the profits generated by AI-driven businesses may escape taxation altogether or be subject to low effective tax rates in jurisdictions with more favorable tax regimes.

To address these challenges, the ad hoc committee must develop new international tax rules and cooperation mechanisms that are specifically tailored to the realities of the AI-driven economy. This may involve the creation of new nexus and profit allocation rules that take into account the unique characteristics of AI, such as the role of data and the fragmentation of the AI value chain. It may also require the establishment of global standards for the valuation and taxation of intangible assets, such as AI algorithms and datasets, to ensure that the profits generated by these assets are properly attributed and taxed. The committee should consider the distributional implications of AI-driven value creation and ensure that the benefits of AI are shared more equitably among countries. This may involve the development of mechanisms to ensure that countries in the Global South, which often provide the data and human capital that fuel AI innovation, can assert their taxing rights and capture a fair share of the value generated by AI-driven businesses.



Robert Goulder of *Tax Notes* and Lyla Latif of Warwick Law School discuss the importance of considering artificial intelligence as the U.N. aims to create a more inclusive, equitable, and effective global tax system.

Limitations in the AI-Driven Economy

The rise of AI has led to what Abeba Birhane terms "algorithmic colonization," a phenomenon characterized by the dominance of Western-developed AI solutions in the Global South, often imposed without adequate consideration for local contexts, needs, and values.[4] This algorithmic invasion not only perpetuates power imbalances and undermines the development of indigenous technology ecosystems, but also creates complex tax challenges. Because AI systems are developed and controlled by a handful of multinational enterprises based in the Global North, the profits generated through their deployment in the Global South often bypass local tax authorities, depriving those countries of crucial revenue for development and public welfare.

The global nature of AI development, with hardware and software components designed and produced in different jurisdictions, adds another layer of complexity to the tax landscape. MNEs can strategically distribute their research and development activities, intellectual property holdings, and data processing across multiple countries to minimize their tax liabilities, exploiting gaps and mismatches in international tax rules. This fragmentation of the AI value chain makes it difficult for tax authorities to determine where value is created and how profits should be allocated for taxation purposes.

The OECD's base erosion and profit-shifting project,[5] which includes initiatives such as the automatic exchange of information (AEOI),[6] the common reporting standard (CRS),[7] and country-by-country reporting,[8] has made significant strides in addressing tax avoidance and promoting transparency in the global tax system. However, these initiatives were primarily designed to tackle issues related to traditional business models and may not fully capture the complexities arising from the AI-driven economy, particularly in the context of data-intensive MNEs. The BEPS project focuses on addressing issues such as transfer pricing, treaty abuse, and the shifting of profits to low-tax jurisdictions. Although these issues are still relevant in the context of AI, the unique characteristics of data-driven business models add a new layer of complexity that may not be adequately addressed by the existing BEPS framework.

Data has become a critical asset for AI-driven MNEs, enabling them to generate significant value through the collection, processing, and analysis of vast amounts of user information. However, the value of data is often difficult to quantify and attribute to specific jurisdictions because it can be collected from users worldwide and processed in multiple locations. This makes it challenging for tax authorities to determine where value is created and how profits should be allocated for taxation purposes. These data-intensive MNEs often rely on complex global value chains, with different stages of the data processing and AI development process taking place in different jurisdictions. For example, an MNE may collect data from users in one country, process it in another, and use the insights generated to develop AI algorithms in a third. This fragmentation of the data value chain allows MNEs to strategically allocate their activities and assets among multiple countries to minimize their tax liabilities, exploiting gaps and mismatches in international tax rules.

The BEPS framework initiatives, including AEOI, CRS, and CbC reporting, may not fully capture these complexities because the initiatives focus primarily on the reporting and exchange of financial information related to traditional business activities. Although these initiatives have improved transparency and helped to combat tax avoidance, they may not provide tax authorities with the necessary insights into the value creation processes of data-intensive MNEs and the role of data in their business models.

To address these challenges, the ad hoc committee must consider the specific characteristics of data-driven business models and develop targeted solutions that account for the unique complexities of the AI economy. This may involve the development of new reporting standards and information exchange mechanisms that specifically address the role of data in value creation and the fragmentation of the data value chain. For example,

the committee could consider extending the CbC reporting framework to require MNEs to report on their data collection, processing, and AI development activities in each jurisdiction where they operate. This would provide tax authorities with a more comprehensive picture of how data-intensive MNEs create value and allocate profits among different countries.

The committee could also explore the development of new nexus and profit allocation rules that take into account the unique characteristics of data-driven business models. This may involve the creation of new concepts, such as AI-enabled permanent establishments, which would allow countries to assert their taxing rights over the profits generated by AI-driven MNEs based on their digital presence and user engagement, rather than their physical presence.

IP, Knowledge Predation, and Colonialism

IP in the context of AI poses additional challenges.[9] Large technology companies engage in what Cecilia Rikap and Bengt-Åke Lundvall call "knowledge predation": extracting valuable data and insights from firms and research institutions in the Global South to fuel their AI innovation.[10] This predatory practice not only stifles local innovation but also enables MNEs to accumulate significant intangible assets, such as patents and trade secrets, which are often held in low-tax jurisdictions. The resulting concentration of IP ownership in the hands of a few powerful actors further skews the distribution of AI-generated profits and makes it difficult for countries in the Global South to capture a fair share of the value created within their borders.

Rikap and Lundvall explain that this predatory practice can be seen as a form of colonial invasion, committed through AI. It bears striking similarities to the exploitation of African raw materials during the colonial era,[11] which led to underdeveloped economies and illicit financial flows, as the profits generated from the exploitation of these raw materials were channeled back to the colonial powers, rather than being invested in local development.[12] The concentration of IP ownership in the hands of a few powerful actors in the Global North perpetuates unequal exchange and results in tax asymmetries that the ad hoc committee must address.

These asymmetries arise due to the ability of large technology companies to strategically allocate their IP and profits across different jurisdictions to minimize their tax liabilities. As a result, countries in the Global South are left without the necessary resources to invest in

their own development and are unable to capture a fair share of the value created within their borders.

Scholars such as Nick Couldry and Ulises Mejias[13] and Shoshana Zuboff[14] have also highlighted the dangers of this new form of colonialism through AI, warning of the potential for exploitation and the concentration of power in the hands of a few dominant actors. They argue that this practice undermines the autonomy and self-determination of individuals and communities in the Global South because their data and insights are appropriated for the benefit of large technology companies in the Global North. To address this issue, the ad hoc committee must therefore critically focus on the problem of knowledge predation and the resulting concentration of IP ownership.

One approach would be to develop new nexus and profit allocation rules that take into account the value of data and insights extracted from the Global South. This could involve the creation of new concepts, such as data-source taxation, which would allow countries to assert their taxing rights over the profits generated by AI based on the origin of the data and insights used to develop these technologies. The ad hoc committee could also explore the development of global standards for the valuation and taxation of intangible assets, such as patents and trade secrets, to ensure that the profits generated by these assets are properly attributed and taxed in the countries where the value was created. This could involve the creation of new reporting and disclosure requirements for large technology companies, to provide greater transparency on their IP holdings and the value generated by their AI activities in different jurisdictions.

The Limitations of Pillar 1

Data, the fuel of AI systems, presents a critical challenge for international tax cooperation. AI relies heavily on the collection, processing, and analysis of vast amounts of data, raising questions about how to attribute value to data and tax its use. Data is often treated as a free raw material, with little consideration for the rights and interests of the individuals and communities from whom it is collected. Profits derived from data-driven AI are primarily captured by MNEs, while the countries and populations that generate the data are left without a fair share of the benefits.

The OECD's pillar 1 proposal, which aims to address the tax challenges arising from the digitalization of the economy,[15] falls short in adequately addressing the structural aspects of AI. Although pillar 1 seeks to allocate a portion of the profits of large MNEs to the

countries where their users are located, it sets high thresholds that only apply to a handful of the largest companies. This narrow focus fails to capture the broader impact of AI on the global economy and does not account for the complex web of value creation and profit shifting that characterizes the AI landscape.

To effectively address the tax challenges posed by AI, the ad hoc committee must adopt a comprehensive and nuanced approach that goes beyond the limitations of existing proposals like pillar 1. This approach should consider the structural aspects of AI, including the algorithmic invasion, globalized hardware and software development, IP issues, and data-related concerns. It should also prioritize the needs and interests of the Global South, ensuring that countries can effectively participate in the development and governance of AI technologies, assert their taxing rights, and capture a fair share of the value generated within their borders.

Central to this approach should be the development of new international tax rules and cooperation mechanisms that are specifically tailored to the realities of the AI-driven economy. This may involve the creation of new nexus and profit allocation rules that account for the unique characteristics of AI, such as the role of data and the fragmentation of the AI value chain. It may also require the establishment of global standards for the valuation and taxation of intangible assets, such as AI algorithms and datasets, to prevent the erosion of tax bases through the strategic allocation of IP.

Conclusion

In conclusion, the ad hoc committee must recognize the critical importance of addressing the structural aspects of AI as part of its mandate to create a more inclusive, equitable, and effective global tax system. By developing new international tax rules and cooperation mechanisms that are specifically tailored to the realities of the AI-driven economy, and by empowering countries in the Global South to assert their taxing rights and capture a fair share of the value generated within their borders, the committee can help ensure that the benefits of AI are more evenly distributed and that the global tax system remains relevant, responsive in the face of rapid technological change, and most importantly, fair to the Global South.

FOOTNOTES

[1] OECD, “Tax Challenges Arising From Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two)” (2021); OECD, “Tax Challenges Arising From Digitalisation

— Report on Pillar One Blueprint" (2020); Lyla A. Latif, "The Evolving 'Thunder': The Challenges Around Imposing the Digital Tax in Developing African Countries," 4(1) *Int'l J. Digital Tech. & Econ.* 34 (2020).

[2] G.A. Res. 78/230 (Dec. 22, 2023).

[3] Chen Yu, "AI Revolution: Reshaping Global Value Chains for the Future," Center for Open Science, No. n6hb2 (2023).

[4] Birhane, "Algorithmic Colonization of Africa," 17(2) *scripted* 389 (2020).

[5] OECD, "Action Plan on Base Erosion and Profit Shifting" (2013).

[6] OECD, "Standard for Automatic Exchange of Financial Account Information in Tax Matters" (2017); OECD, "Automatic Exchange Portal."

[7] OECD, "Model Mandatory Disclosure Rules for CRS Avoidance Arrangements and Opaque Offshore Structures" (2018).

[8] OECD, "Guidance on the Implementation of Country-by-Country Reporting — BEPS Action 13" (2022).

[9] Kathleen Wills, "AI Around the World: Intellectual Property Law Considerations and Beyond," 102 *J. Pat. & Trademark Off. Soc'y* 186 (2022); José Carlos Erdozain, "How Will the IP World Respond to the Rise of AI?" 281 *Managing IP* 56 (2019).

[10] Rikap and Lundvall, "Big Tech, Knowledge Predation and the Implications for Development," 12(3) *Innovation & Dev.* 389 (2022).

[11] Michael Kwet, "The Digital Tech Deal: A Socialist Framework for the Twenty-First Century," 63(3) *Race & Class* 63 (2022).

[12] Latif, "The Lure of the Welfare State Following Decolonisation in Kenya" in *Imperial Inequalities: The Politics of Economic Governance Across European Empires* 240-258 (2022).

[13] Couldry and Mejias, *The Costs of Connection: How Data Is Colonising Human Life and Appropriating It for Capitalism* (2019).

[14] Zuboff, *The Age of Surveillance Capitalism: The Fight for a Human Future at the New Frontier of Power* (2019).

[15] OECD, pillar 1 blueprint, *supra* note 1.

END FOOTNOTES