Adopting a Central Banking Digital Currency: A Tax Policy Perspective

By:

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Introduction

Since the advent of so-called cryptocurrencies and so-called stablecoins, there has been a growing interest in the possible introduction of a Central Bank Digital Currency (CBDC). Indeed, the opportunities offered by new technologies such as blockchain and the possibility for private stakeholders to start playing a role in global monetary policies, require central banks to "*be ahead of the curve*". During the last years, projects were launched by many central banks around the world. Even during the COVID-19 pandemic, proposals and further testing to adopt a CBDC have been flourishing around the world. As reported in newspapers, the Digital Currency Research Institute of the People's Bank of China confirmed that trial programmes via China's state-owned banks in four cities – Shenzhen, Suzhou, Xiongan and Chengdu – have started. Moreover, in a counter-proposal to the Stimulus package in the US, there has been a reference to the possibility to introduce a digital dollar account maintained by a Federal

reserve bank to deliver benefits in response to the pandemic crisis. However, while the debate and research on how to design a CBDC is still heated, little attention has been paid to the consequences of introducing a CBDC from a tax policy perspective.

Why is the adoption of a CBDC relevant for tax policies?

Indeed, the use of digital payments at the detriment of cash has been central also in anti-money laundering (AML) and tax policies. In these areas, States have already adopted different policies to incentivise the use of electronic payments, also considering the development of automatic exchange of the relevant tax and AML information. It goes without saying that the more electronic payments take place, the more information from financial institutions gathered for AML and tax evasion purposes will be exchanged. Examples of provisions favouring the use of electronic payments can be found in several jurisdictions. For example, in Argentina and Korea, tax incentives, such as reduced VAT or turnover tax rates, aiming at encouraging the use of electronic and digital payments have already been adopted. At the same time, some countries have required businesses to use point-of-sale (POS) devices and accept card payments. Because cash is perceived as a facilitator of shadow economies, in many European countries quantitative limits on the use of cash for purchases have been introduced. A World Bank study shows countries have also started to limit the use of cash for expenses eligible for business or personal deductions. In Colombia, since January 1, 2014, expenses for deductible tax purposes could only be made through payment methods such as deposits in bank accounts, bank transfers, checks and credit or debit cards. Similarly, in Mexico, payments above 2,000 pesos can be deducted as company expenditures only if made through electronic transfer of funds by personal check or credit, debit, service cards. Finally, starting from January 1, 2020, in Italy certain expenses will be deductible from the personal income tax only if the payment was made through traceable means of payment, such as bank transfers, credit and debit cards. In the last Italian Budget Law there are two relevant provisions going in this direction. The first one allows tax deductions for many of the deductible expenses only if payments take place through bank transfer or credit cards. Differently, the second one grants a reimbursement to subjects frequently using electronic payments outside their business activity.

At the same time, in some countries, taxpayers are also obliged to pay fees and taxes only through electronic payments. For instance, a German taxpayer was recently refused the payment in cash of the German broadcast fee which according to the State Hessen statute could only be paid in electronic or bank transfer form. This case is now object of legal dispute and led the German Federal Administrative Court (Bundesverwaltungsgericht) to raise before the European Court of Justice (ECJ) the issue of whether policies restricting the use of cash (the only legal tender in the European Union) could impact on monetary policies which are of EU exclusive competence. The choice to require tax and fees payments only in electronic form has been justified in terms of efficiency in the management of payment for tax authorities. However, according to Art. 128 TFEU legal tenders are only banknotes issued by the European Central Bank and national central banks together with the coins issued by the Member States subject to approval by the European Central Bank. Indeed, the introduction of a euro as a CBDC with the legal tender status can circumnavigate the issues that have been raised before the ECJ. The digital equivalent of a euro banknote with the legal tender status will offer a justification ground for Member States to impose tax and fee payments or grant benefits only when that digital form of the legal tender is used. Nevertheless, broader implications derive from Member States' decision to limit payments or give reimbursement in just one of the forms of legal tenders admitted within the Euro-zone (i.e. the electronic version of the euro).

Digital Divide and Data Protection issues at stake

When introducing tax policies favouring the use of digital means of payment over cash, there are two main areas of concern which shall not be underestimated, namely: the digital divide and data protection. Measures limiting the use of cash can have severe impacts on the most vulnerable groups of our society, e.g. the elderly who are not familiar with new technologies or people living in remote areas with poor Wi-Fi connections or lacking necessary infrastructures. When looking at the European Commission's Digital Economy and Society Index (DESI) whose data for 2019 were released in the middle of the pandemic, it emerges that there are still too many EU citizens that have never used the internet and many of them belong to vulnerable categories. It can be easily assumed that the percentage of internet usage as well as online services, whether provided by private or public stakeholders, might have

increased due to the pandemic. Nonetheless, what emerges from the last DESI data is still very significant in order to take consciousness of what still needs to be done and before taking further steps favouring electronic and digital payments over cash. Especially in relation to granting expenses deduction only in cases where electronic and digital payment systems were used, financial and digital literacy of the taxpayers must be taken into consideration. As it concerns digital literacy, the DESI data shows how within the European Union there are still strong discrepancies among countries in the number of internet active users. In some Member States, over one-quarter of the population still does not regularly go online (*e.g.*33% in Bulgaria and 28% in Romania). Despite the 2019 slight decrease in the share of people who have never gone online and that we can expect a similar trend in 2020, in 2019 the current share of 9.5% unconnected people in the EU warrants further action. Moreover, data shows that most active internet users are young individuals (97% of those aged between 16 and 24 are regular internet users), those with a high level of formal education (97%) and students (98%) whereas there is still a high number of non-users among people with no or low education levels (24%), those aged between 55 and 74 (23%), and retired and inactive people (26%). From these data, it clearly emerges that some of the most vulnerable members of our society based on their age or their level of education might not be sufficiently digital literate and might not able to comply with provisions imposing the use of digital means of payment.

Issues concerning the ability to pay principle also arise. Tax deductions, one of the core elements of the progressivity of an income tax, will be granted only if the relative expenses have been paid with the electronic version of the legal tender. Thus, the amount of income subject to tax will depend on the form of legal tender used and taxes will not be paid based on the actual ability to pay of the taxpayer but based on the means of payment used for the deductible expenses. This clearly determines a different treatment between taxpayers based on their digital skills and not ability to pay. Tax deductions and exemptions aim at sparing from taxation taxpayers' income granting them a minimum subsistence. Since taxation shall not lead to increased poverty under minimum survival standards, they are not only a derivation of the ability to pay principle, but they are a concrete expression of the notion of human dignity.

At the same time, a cashless society imposes important questions in terms of data protection. The increasing use of digital forms of cash, the electronic recording of those transactions and the exchange of the relevant information between different stakeholders at national and international level require taking into consideration which information and how those data will be exchanged in order to protect taxpayers' right to privacy. Depending on the level of anonymity with which a CBDC will be designed, a digital euro can allow the monitoring of each transaction involving this type of payments. However, this also entails that in cases where a CBDC is issued by the central bank where taxpayers' accounts are directly held, that central banks will have a complete overview of all possible taxpayers' information and data. These data can certainly be relevant for tax authorities as well. As previously highlighted, there is a great interest by tax administrations to monitor transactions aiming at preventing tax evasion and fraud. Thus, the availability of the data collected by the central banks will enable them to better scrutinize possible evasion and fraud cases. Nonetheless, the transfer or access to data held by the Central Banks and the subsequent transfer of those data to other tax authorities raise additional privacy concerns that shall be taken into account already when designing a CBDC.

At the moment, tax authorities have already access to information hold by commercial financial institutions and they are already automatically exchanging this type of data. This is the result of the great effort of the last years to strengthen cooperation among tax authorities aiming at fighting tax evasion at fraud. It goes without saying, that once data will be gathered by central banks in relation to transactions where a digital euro has been used and this data will be made available to tax authorities, the same data will also be transmitted to AML and foreign tax authorities. Indeed, the type of technologies on which a CBDC will be based can make an important difference in the level of data protection risk. For instance, the use of a distributed ledger or a centralized system will differently impact on how tax authorities will be given access and then will be able to forward those data. Furthermore, whether the CBDC will be issued directly by central banks or through the involvement of commercial banks and whether these CBDC will be made available to the broad public or just to a close targeted audience, will make difference in how personal and non-personal data will be stored and transferred among several or few

different types of stakeholders.

Conclusions

Adopting an electronic version of the euro and granting it the legal tender status would certainly allow States to adopt more stringent policies for fighting AML and tax evasion. Even though most of the references and examples in this contribution were focusing on the EU context, similar conclusions can be drawn for other parts of the world. While new technologies such as a CBDC could represent an additional tool at disposal of tax authorities to fight tax evasion and fraud, issues concerning the digital divide and privacy shall be addressed while the debate over the design of a CBDC is still ongoing. For example, a privacy by design approach considering the fact that information available through transactions involving CBDC will be exchanged internally and internationally among different public authorities, might be a viable solution. Differently, in terms of digital divide, more proportionate policies favouring digital payments could provide for certain exceptions and different payment requirements for the worse off groups of our communities (*e.g.* the elderly). In the end, it is all about seizing the opportunities offered by a CBDC in a more inclusive way while ensuring the protection of personal data and privacy.

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