E/C.18/2019/CRP.16

Distr.: Limited
Members
30 September 2019
Original: English

Committee of Experts on International Cooperation in Tax Matters
Nineteenth session
Geneva, 15-18 October 2019
Item 3(i) of the provisional agenda
Tax consequences of the digitalized economy – issues of relevance for developing countries

Co-coordinators' Report on Work of the Subcommittee on Tax Challenges related to the Digitalization of the Economy

Summary

This paper responds to the request during the 18th Session of the Committee in April, in order to take forward work on the tax consequences of the digitalized economy, for the Subcommittee to draft a paper for presentation at the 19th session of the Committee addressing various developments, issues and options.

The state of discussion in the Subcommittee, and more broadly, means that it has not yet been able to draw final agreed conclusions on the questions to be asked, issues, and options.

As a result, this paper represents a work in progress to help promote focused and worthwhile discussion of these issues at the Subcommittee meeting on 13th October in Geneva and in Committee discussions at the 19th and future sessions.

Nothing in this paper should be considered to represent concluded views of either the Subcommittee or the Committee. It is an attempt to focus the discussion on some of the issues on which the Committee should take a position in order to be able to decide at a later stage which recommendations could be included in the UN Model Convention or in other guidance documents emanating from the Committee.

Guidance is sought from the Committee at the 19th Session on the future scope and direction of this work.

BACKGROUND

Purpose of this paper

This paper was prepared for discussion by the Subcommittee on Tax Challenges Related to the Digitalization of the Economy at its meeting on Sunday 13 October.

2. It will also be distributed to the full membership of the Committee to be discussed, together with the results from the meeting of the Subcommittee, at its 19th Session in October 2019 in Geneva.

3. It follows up on what was discussed during the 18th Session held in April in New York, at the end of which the Committee agreed that the way forward with respect to the tax consequences of the digitalized economy would be for the Subcommittee to draft ***a paper for presentation at the 19th session of the Committee:***

(a) Including an explanation and evaluation of proposals internally developed or developed in other forums;

(i) Describing the advantages and disadvantages of the abovementioned proposals;

(ii) Giving special attention to:

a. The interests of developing countries;

b. Administrability, fairness and certainty;

(iii) Taking into account different economies and market forces;

(iv) Without losing sight of the principles agreed at the meeting of the Subcommittee held in January 2019, as indicated in paper E/C.18/2019/CRP.12;

(b) Considering, where relevant, expert commentaries on issues relating to the digitalized economy;

(c) Aiming at finalized proposals within the term of the current membership of the Committee.

4. The ***proposed parts*** to be included in the paper were as follows:

1. Introduction, general background, reasons for the work and guiding principles;
2. Relevance and analysis (advantages and disadvantages) of work in other forums:
    (a) Inclusive Framework on Base Erosion and Profit Shifting;
    (b) International Monetary Fund;
    (c) European Union;
    (d) African Tax Administration Forum;
    (e) Others;
3. Possible alternative or modified approaches for allocation of taxing rights and nexus rules, including withholding taxes;
4. Conclusions.

5. This paper follows that agreed division of parts, to the extent that material is available and with a slight reordering of some of the current developments.

Part 1: Introduction, general background, reasons for the work and guiding principles;

Special Caveat

6. Neither the totality of this paper nor its individual parts should be considered to represent concluded views of either the Subcommittee or the Committee. It is an attempt to focus the discussion on some of the issues on which the Committee should take a position in order to be able to decide at a later stage which recommendations could be included in the UN Model Convention or in other guidance documents emanating from the Committee.

7. Rather than drawing final or even interim conclusions on the matters within the Subcommittee's purview. this paper draws upon the issues, questions and uncertainties that are evident in current discussions, both in the Committee and in other fora. There are many different and divergent views on such issues and even the issue of what are the correct questions to ask on these matters can be a matter for principled differences

8. This paper is therefore merely aimed at helping to structure future discussions and facilitating the articulation of issues and the drawing or confirmation of Committee conclusions.

Discussions in the Committee so far

9. The issue of how to tax companies in the digital economy has been increasingly discussed over the last five to ten years.

10. Action 1 of the OECD/G20 BEPS project was devoted to the issue. In 2015 the Final Report was published. Work was continued in the context of the OECD/Inclusive Framework on BEPS which resulted in an Interim Report in 2018 and a Working Plan published in 2019.

11. The European Commission in 2018 released proposals. They have, until now not been adopted by the member states but the proposals and the comments give a good indication of the issues.

12. It has also been on the agendas of regional international organizations like CIAT and ATAF.

13. Several jurisdictions have announced or even introduced concrete measures aimed at taxing the digital economy.

14. Finally, the issue has of course attracted the interest of many practitioners and academics and extensive literature has been published.

15. In that light there were excellent reasons for the new membership of the UN Tax Expert Committee to agree during its first meeting in 2017 that work should be undertaken in this field and a subcommittee be formed to take up that work.

16. The mandate of the Subcommittee reads:

> "*The Subcommittee is mandated to draw upon its own experience as a body widely representative of affected stakeholders and engage with other relevant bodies and interested parties with a view to:*
>
> - *Analyzing technical, economic and other relevant issues;*
> - *Describing difficulties and opportunities especially of interest to the various affected agencies of developing countries;*
> - *Monitoring international developments;*
> - *Describing possible ways forward; and*
> - *Suggesting measures and drafting provisions related to the digitalization of the economy, with regard to:*
>   - *Income taxes;*
>   - *Double tax treaties;*
>   - *Value added tax as well as other indirect taxes; and*

17. The Subcommittee met in the sidelines of the 16th and 17th meeting of the Committee and it held a special meeting in Paris on the 16-18 January 2019. During that meeting it was decided that it was important for the Committee *to adopt an approach independent of similar work being pursued in other fora, while giving due consideration to developments which will inform its work.* At the end of the meeting a subgroup was constituted to develop a Paper based on the following guiding principles

- Avoiding both double taxation and non-taxation;
- Preferring taxation of income on a net basis where practicable; and
- Seeking simplicity and administrability

18. That Paper (E/C.18/2019/CRP.12) was discussed during the 18th session by the Subcommittee and the Committee which lead to the Paper in front of you, as explained in the Summary.

Points to be discussed during the 19th Session

19. The ongoing discussion, in international organizations, in literature, in politics, in the press and in the Committee reveals that in order to move forward some key questions still need to be answered and the Committee will also have to take a position on these. Given its mandate the Committee should give special attention to the interest of developing countries in answering these questions. However, the Committee should also be aware that to reach a sustainable solution for the longer term a principled approach has its merits.

Some Key Questions and Frames of Reference

The "Why?"

20. The first question is why we are having this discussion and why so many voices are calling for changes to account for new digitalized business models? What is the problem we are trying to solve?

21. Based on what was brought forward during discussion at the Committee's 18th session it appears that (at least) four arguments (or assumptions) play a role in addressing the "Why" of this issue.

22. The first argument heard is that (certain) digital companies ("tech companies") pay a *very low worldwide effective tax rate*. Leaving aside a discussion on the validity of the suggested figures, the questions this argument raises is whether that is only true for digital companies and to what extent that will be solved when countries introduce the measures proposed in the BEPS project or when certain national tax reforms start showing their effect. An example of that might be the US Tax Cut and Jobs Act.

23. A related argument refers to *business restructuring.* The perceived problem is that companies change their business models, drawing away functions from market jurisdictions and attributing risks and (therefore), based on the current principles of transfer pricing, profits to low tax jurisdictions. Moreover, the risk is that related companies can agree to changed arrangements on paper between themselves that would not change the real functions performed but could lead to an artificial shifting of profits.

24. Here too, the question is whether that area of concern is restricted to digital companies, and to what extent will it be solved by introducing the relevant BEPS measures? Also, in cases where *real* functions have moved, it raises the question of whether the result is really contrary to existing principles on attribution of taxing rights on profits.

25. A third argument holds that the *current transfer pricing rules* and their reliance on the arm's length principle, allocating corporate profits based on the location of value creation by firms *are generally satisfactory but that the approach needs updating to take into account ways in which firms create value through remote activities.* In that view a portion of the value added by producers through user participation or through the use of marketing intangibles associated with the consumer market, should be taxed in the user or market jurisdictions.

26. A final argument is that the currently accepted international principles of transfer pricing are not satisfactory and that *a share of corporate profits should be allocated to the market jurisdiction on the basis that the market demand is a key precondition for those profits*.

27. Although this is an argument that cannot be qualified as right or wrong, it is simply a matter of policy choice and preference, it again raises the question what the consequences should be for other sectors than digital companies. Markets are valuable for any business and if a shift of taxing rights from the location of production to the location of consumption markets should be agreed, the question could arise why the effect should be restricted to digital companies.

The "Who?"

28. A second question is which companies should be affected by tax challenges related to digitalization. To a certain extent the answer to this question follows from the answer given to why we should introduce new tax rules.

29. A point to be discussed in this context is whether the single entity approach is still satisfactory. "Groups of related entities" might be the subject of a reallocation of taxing rights. That might conflict with the need that, at a certain point, for legal and administrative reasons, probably one single entity will have to be determined to be the formal tax payer.

30. An important consideration is what exactly is meant by digital economy and digital companies and whether that sector can, or should, be ring-fenced from others.

31. The OECD 2015 Report on Taxation of the Digital Economy[1] concludes that the digital economy is increasingly becoming the economy itself and that it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes.

32. Despite that conclusion, the OECD 2018 Interim Report[2] suggests three factors that are frequently observed in highly digitalized businesses.

- Scale without mass
- The importance of intangible assets (intellectual property)
- User participation and reliance on data

33. Regarding the scope of possible measures many proposals include a turnover threshold. Others include additional factors to take into account.

34. The question arises on which principle can the restriction of the scope of measures to certain "digital" or "tech" companies be based.

35. Under the last argument discussed above under "Why?" it is the market jurisdiction that should be compensated for the fact that it provides and sustains a market with buying capacity. If that argument is used, the question comes up why the scope of possible measures should be limited at all. On different occasions it has been suggested that commodities and extractive sectors should be excluded, and this approach certainly seems to be in the interest of developing countries. However, the argument to do so seems to deserve some elaboration.

36. Attention will also have to be given to the distinctions and similarities between business-to-business and business-to-consumer chains.

The "What?"

37. The next question is what the object of taxation should be. Based on the different arguments outlined it seems obvious that the object should be "the part of the net profit of the group of related entities that, based on the new principles, is agreed to be attributed to the market jurisdiction".

[1] OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, p 11.

[2] OECD/ Inclusive Framework, *Tax Challenges Arising from Digitalisation – Interim Report 2018,* p.24.

38. If that is agreed questions to be answered are:

- What to do when a group of related entities is in a loss position?
- Which "non-market" part of the group of related entities will be assumed to realize a lower profit and be correspondingly taxed less?

The "How?"

39. An extremely important question for developing countries will be how to apply any new tax rules. Given the limited resources (capacity and expertise and experience) a simple approach is preferable.

40. An adaptation of the concept of permanent establishment has been proposed including the idea of creating the concept of a digital PE. Alternatively, there is the alternative to create a new taxing right based on an approach comparable to the one regarding fees for technical services in article 12A of the UN model.

41. A potential option for collection that could have simplicity advantages is a withholding tax. However simple that sounds, it remains to be determined who the withholding agent will be and on which payments tax should be withheld. More fundamentally the relation with corporate income taxation on net profit will have to be determined.

Additional Issues

42. An issue that the Subcommittee and the Committee might wish to discuss during its 19th session is the work currently undertaken in the OECD/Inclusive Framework under the so-called Pillar Two. Where Pillar One concentrates on the questions raised above, Pillar Two aims at creating a set of regulations that will guarantee that companies pay a minimum amount of tax somewhere.

43. At this moment that discussion clearly goes beyond the mandate of the Subcommittee but given the importance of the issue (which has been recognized by the Committee) and the progress that is being made it may be appropriate that the Committee consider the issue.

Part 2: Relevance and analysis (advantages and disadvantages) of work in other forums:

(a) INCLUSIVE FRAMEWORK ON BASE EROSION AND PROFIT SHIFTING

44. The tax challenges arising from the digitalization of the economy were identified as one of the main areas of focus of the G-20/OECD Base Erosion and Profit Shifting (BEPS) Action Plan, leading to the 2015 BEPS Action 1 Report on *Addressing the Tax Challenges of the Digital Economy* (the Action 1 Report). The Action 1 Report recognized that digitalization and some of the business models that it facilitates present important challenges for international taxation. The Report also acknowledged that it would be difficult, if not impossible, to 'ring-fence' the digital economy from the rest of the economy for tax purposes because of the increasingly pervasive nature of digitalization. The Report observed that beyond BEPS,

digitalization raised a series of broader direct tax challenges, chiefly relating to the question of how taxing rights on income generated from cross-border activities in the digital age should be allocated among countries. While identifying a number of proposals to address these concerns, none were ultimately recommended.

45. After the OECD/G20 BEPS package, the TFDE continued to work under aegis of the IF and came out with an interim report, *Tax Challenges Arising from Digitalisation – Interim Report 2018* (the Interim Report). As regards the broader tax challenges relating to the allocation of taxing rights, the Interim Report first provided an in-depth analysis of new and changing business models in the context of digitalization. This enabled the identification of three characteristics i.e., cross jurisdictional scale without mass, reliance on intangible assets including IP and data and user participation/synergies with IP, that are frequently observed in certain highly digitalized business models, and the discussion of their implications for the existing profit allocation and nexus rules. It was noted, however, that countries had different views on the scale and nature of these challenges. The Interim Report described countries as falling into three groups, which ranged from countries that considered that there was a need to change the existing profit allocation and nexus rules to varying degrees (i.e., first and second groups) to countries that considered that no action was needed beyond addressing BEPS issues (i.e., third group).

46. While members of the Inclusive Framework did not converge on the conclusions to be drawn from this analysis, they committed to continue working together to deliver a final report in 2020 aimed at providing a consensus-based long-term solution, with an update in 2019. Since the delivery of the Interim Report, the IF and the TFDE continued their work including on addressing broader tax challenges.

47. As stated in the Policy Note "*Addressing the Tax Challenges of the Digitalisation of the 47Economy*"[3], the Inclusive Framework agreed to examine and develop, on a "without prejudice" basis, proposals that were grouped into two pillars -discussed and explored in parallel- which could form the basis for consensus:

- Pillar One focuses on the allocation of taxing rights, and seeks to undertake a review of the profit allocation and nexus rules;
- Pillar Two focuses on the remaining BEPS issues and seeks to develop rules that would provide jurisdictions with a right to "tax back" where other jurisdictions have not exercised their primary taxing rights, or the payment is otherwise subject to low levels of effective taxation.

48. One of the major challenges for the Inclusive Framework is to bridge the gaps between the different positions of jurisdictions, taking into consideration the overlaps that exist between the BEPS issues exacerbated by digitalization and the broader tax challenges. A public consultation document was released on 13 February 2019, which sought input from external stakeholders on the specific proposals examined under Pillar One and Pillar Two.

49. According to the Programme of Work developed by the Inclusive Framework with a view to reporting progress to the G20 Finance Ministers in June 2019, in order to deliver a long-term and consensus-based solution in 2020, the outlines of the architecture will need to be agreed by January 2020. The outline will have to include a determination of the nature of, and the interaction between, both Pillars, and will have to reduce the number of options to be pursued under Pillar One. The solution is expected to achieve a balance between accuracy and

[3] As approved by the Inclusive Framework on BEPS on 23 January 2019, OECD 2019

simplicity in order to allow its implementation by all jurisdictions regardless their level of development. Additionally, the outline will have to be conceptually based on sound economic principles. Finally, the global solution should avoid both taxation where no economic profit is derived as well as double taxation.

50. The Inclusive Framework Programme of Work recognizes that new technical issues may emerge as the work progresses and that there are cross-cutting issues that affect both Pillars requiring close coordination.

Pillar One - Revised Nexus and Profit Allocation Rules

51. Under the first pillar, the IF/TFDE has been considering three approaches focusing on the allocation of taxing rights (the "broader tax challenges") that would modify the rules on profit allocation and nexus based on the concept of user contribution or marketing intangibles; namely, the "user participation" proposal, the "marketing intangibles" proposal and the "significant economic presence" proposal. On nexus, all three approaches argue for a re-thinking of the traditional nexus concept and, in different ways and different extents, go beyond the limitations on taxing rights determined by reference to a physical presence.

52. These proposals have important differences, including the objective and scope of the reallocation of taxing rights but they present some commonalities, since they all allocate more taxing rights to the jurisdiction of the "market jurisdictions" in situations where value is created by a business activity through (possibly remote) participation in that jurisdiction that is not recognized in the current framework for allocating profits.

53. Among their common policy features, they all consider the existence of a nexus in the absence of physical presence, foresee using the total profit of a business, contemplate the use of simplifying conventions (including those that diverge from the arm's length principle) to reduce compliance costs and disputes.

54. Two of the approaches (the user participation and marketing intangible proposals) are based on the principle that business profits should be taxed in the countries in which value is created and argue that the profit allocation and nexus rules should be amended to better reflect that principle. The user participation proposal was conceived to apply only to certain business models highly reliant on user participation (e.g., social media platforms, search engines, and online marketplaces), while the marketing intangibles proposal was thought to apply to businesses that have significant marketing intangibles. The common point both approaches are seeking to address is that a business with a physical situs outside of a market jurisdiction can nonetheless be said to have an active presence or participation in that jurisdiction and *generate value* in that jurisdiction through its user or customer-related activities, even if they are conducted remotely. Under the existing methods, unless an enterprise is physically present in a user or customer's jurisdiction, including through a dependent agent, it generally will not be subject to tax there.

55. Under the user participation and marketing intangible approaches, even where the physical situs of a business is substantially outside of a market jurisdiction, it is possible for that business to have an active presence or participation in that jurisdiction and generate value through customer/user facing activities that can be said to take place in that jurisdiction. The user participation approach is intended to be relatively narrow in scope and apply to taxpayers in certain businesses, including online advertising and certain multisided platforms -those for whom user participation is seen as representing a significant contribution to value creation- and only applies to the income attributable to such user participation. The marketing intangible approach is likely to cover those same companies even if mechanically this approach would

focus more broadly on marketing intangibles found in a range of businesses (particularly consumer products businesses), of which the contributions of an engaged user base would be but one example.

56. The third approach brings in the concept of Significant Economic Presence as the nexus rule to address tax challenges relating to digitalization. The option of "significant economic presence" was one of the three options that were discussed in Chapter VII of the Final Report on Action 1 of BEPS, for addressing the tax challenges of the digital economy. Under this approach, proposed by G-24 countries, a taxable presence in a country would be created when a non-resident enterprise has a significant economic presence on the basis of factors that are evidence of purposeful and sustained interaction with the economy of that country via technology and other automated means.

57. For establishing the nexus in terms of significant economic presence, some factors, which were also referred to in the Action 1 Final Report, are suggested to be taken into account. These are revenue generated on a sustained basis from a jurisdiction, the user base and the associated data input, the volume of digital content collected through a digital platform from users and customers habitually resident in that country and other factors like billing and collection in local currency, website in a local language, delivery of goods to customers being the responsibility of the enterprise or the enterprise providing other support services, say, after-sales service or repairs and maintenance or sustained marketing and sales promotion activities, either online or otherwise, to attract customers to the digital enterprise. The developing countries which made this proposal are of the view that all of the above factors, including possible new factors that are evidence of sustained and purposeful participation of a digitalized enterprise in the economic life of a country need to be discussed and deliberated in detail so as to develop a concrete design of the new rule based on "significant economic presence".

58. On profit allocation, the user participation approach envisages that the profit allocated to a user jurisdiction, in respect of the activities/participation of users, be calculated through a non-routine or residual profit split approach. Under this approach, the profit attributed to the routine activities of a multinational group would continue to be determined in accordance with current rules. A proportion of the non-routine profit of the business would however be allocated, from the entities that are currently realizing that profit to the jurisdictions in which users are located. The proposal acknowledges the potential challenges in calculating non-routine profit across a multinational group, and the additional difficulties that there would be in trying to calculate non-routine profit at the level of an individual business line. It is also acknowledged that this would be a mechanical approach and would rely on formulas that could only approximate the value of users, and the users of each country, to a business.

59. Under the marketing intangibles approach, current profit allocation and nexus rules would be modified to require that the non-routine or residual income of the MNE group attributable to marketing intangibles and their attendant risks be allocated to the market jurisdiction. All other income, such as income attributable to technology-related intangibles generated by research and development and income attributable to routine functions, including routine marketing and distribution functions, would continue to be allocated among members of the group based on existing transfer pricing principles. Alternatively, the allocation could be done under a revised residual profit split analysis that uses more mechanical approximations.

60. As with any residual profit split this would require a number of steps including the determination of relevant profit, the determination of routine functions and their compensation, the deduction of routine profit from total profit and finally the division of the remaining or "residual" profit. In this regard, there are different ways in which routine profit could be

determined for purposes of computing the amount of non-routine income to be subject to the profit split, ranging from a full transfer pricing facts and circumstances analysis to a more mechanical approach (e.g., a mark-up on costs or on tangible assets). Second, and once the amount of routine profit is determined and subtracted from total profit, there are different ways of determining the portion of non-routine or residual profit attributable to marketing intangibles, ranging from, e.g., cost based methods (e.g., costs incurred to develop marketing intangibles versus costs incurred for R&D and trade intangibles) to more formulaic approaches (e.g., using fixed contribution percentages, which may differ by business model).

61. Once the amount of income attributable to marketing intangibles is determined it would be allocated to each market jurisdiction based on an agreed metric, such as sales or revenues. In this context revenue of MNE's active in the advertising industry, as many digital businesses are, would be sourced not by reference to the residence of the payer but by reference to the customers that are targeted by the advertisement – e.g., in the online platform context, generally the users of the platform.

62. The commonalities among the approaches in Pillar One suggest that there is sufficient scope to consider together some key design features of a consensus-based solution. According to the Programme of Work, the technical issues that need to be resolved may be grouped into three building blocks:

- different approaches to determine the amount of profits subject to the new taxing right and the allocation of those profits among the jurisdictions;
- the design of a new nexus rule that would capture a novel concept of business presence in a market jurisdiction reflecting the transformation of the economy, and not constrained by physical presence requirement; and
- different instruments to ensure full implementation and efficient administration of the new taxing right, including the effective elimination of double taxation and resolution of tax disputes.

New profit allocation rules

63. According to the Inclusive Framework Programme of Work, the new taxing right requires a method to quantify the amount of profit reallocated to market jurisdictions, and a method to determine how that profit should be allocated among the market jurisdictions entitled to tax under the new taxing right. Different methods will continue to be explored seeking more simplifications to minimize compliance costs and disputes. The work will consider the feasibility of business line or regional segmentations, different mechanisms to allocate the profit to the relevant market jurisdictions, the design of various scoping limitations and alternative treatments of losses.

64. The Programme of Work would explore options and issues relating to a modified residual profit split method. The Modified Residual Profit Split method would allocate to market jurisdictions a portion of an MNE group's non-routine profit that reflects the value created in markets that is not recognized under the existing profit allocation rules. It involves four steps:

(i) determine total profit to be split;

(ii) remove routine profit, using either current transfer pricing rules or simplified conventions;

(iii) determine the portion of the non-routine profit that is within the scope of the new taxing right, using either current transfer pricing rules or simplified conventions; and

(iv) allocate such in-scope non-routine profit to the relevant market jurisdictions, using an allocation key.

65. The programme of work will explore the issues and alternative options associated with each of these steps, including possible simplifications. Further, given that the scope of the new taxing right is not intended to cover all profit, the Modified Residual Profit Split method will coexist with the existing transfer pricing rules and rules for coordinating these two sets of rules will be necessary to provide certainty and minimize disputes.

66. The fractional apportionment method is the other profit allocation method that is under the scope of the new rules that will be developed by the Inclusive Framework in its Programme of Work. This method involves the determination of the amount of profits subject to the new taxing rights without making any distinction between routine and non-routine profit. This method would involve three steps: (i) determine the profit to be divided, (ii) select an allocation key, and (iii) apply this formula to allocate a fraction of the profit to the market jurisdiction(s).

67. In exploring the development of a fractional apportionment method, the programme of work will analyze options for computing the relevant profits subject to the fractional apportionment mechanism. Such options may include the profit of the selling entity as determined by the current transfer pricing rules, or by applying a global profit margin to local sales, or by any other measures as may be considered appropriate. Different allocation keys will also be taken into account in constructing the formula that would be used to apportion the relevant profit. The Inclusive Framework will also address the interaction between the fractional apportionment approach and the current profit allocation framework.

68. Seeking simplicity and administrability, the Inclusive Framework will consider a simplified approach grounded in the twin considerations of the interest in allocating more profit to market jurisdictions and reducing the ongoing controversies associated with the proper pricing of marketing and distribution activities. A baseline profit in the market jurisdiction for marketing, distribution and user-related activities could be specified. Under such an approach, it would be considered whether the profit allocated to market jurisdictions would be a final allocation or the allocation of a higher return under traditional transfer pricing principles to market jurisdictions would be allowed, (e.g.; where a local distribution company owns and controls all the risks for highly profitable marketing intangibles).

69. Since the profitability of an MNE group can vary according to business lines and regions, to avoid unintended outcomes and distortions, and ensure a proper balance between simplicity and precision, the Inclusive Framework will explore the possibility of determining the profits subject to the new taxing right on a business line and/or regional basis. The Inclusive Framework is also contemplating limitations that could operate either by reference to the nature or the size of a given business. Consideration will be given to the feasibility of business line segmentations and any legal constraint arising from other international obligations. The Inclusive Framework will explore in its Programme of Work the different options available for the treatment of losses under the new taxing right.

New nexus rules

70. Absent a traditional physical presence, the Inclusive Framework will also explore under Pillar One, the development of a concept of remote taxable presence and new a standard for identifying when such a remote taxable presence exists. The work programme will also

consider a new concept of taxable income sourced in a jurisdiction. This taxing right would generally not be constrained by physical presence requirements.

71. Developing a new non-physical presence nexus rule to allow market jurisdictions to tax the measure of profits allocated to them under the new profit allocation rules would require an evaluation of the relative merits of alternative approaches, including: (i) amendments to the definition of a "permanent establishment" (PE) in Article 5 of the OECD Model Convention, and potential ensuing changes to Article 7 of the OECD Model Convention; or (ii) development of a standalone rule establishing a new and separate nexus, either through a new taxable presence or a concept of source.

Implementation of the new taxing right

72. The proposals under Pillar One rely on the reallocation of taxing rights over a proportion of an MNE group's profit, rather than over the profit from specific transactions or activities undertaken by particular separate entities. It is still not clear which member(s) of an MNE group should be considered to derive the relevant income. In consequence, it is still unclear the way source jurisdictions would exercise the reallocated taxing rights, and how residence jurisdictions would provide relief from double taxation of the relevant income. Existing double tax relief mechanisms are also expected to be reviewed. Current dispute prevention and resolution procedures will also be examined in the context of the new nexus and profit allocation rules.

73. The Inclusive Framework will need to address enforcement and collection issues since the tax liability is likely to be assigned to an entity that is not a resident of the taxing jurisdiction. Simplified registration-based collection mechanisms will have to be examined. Additionally, enhanced exchange of information and cooperation mechanisms will contribute for compliance and collection purposes. Where it does not lead to double taxation. as a complementary measure, a withholding tax mechanism will also be explored by the Inclusive Framework. Finally, the work programme will develop recommendations for a system to report and disseminate information needed to administer the new taxing right. One option for such a system could be based on the existing framework and technology used for the exchange of country-by-country reports under BEPS Action 13.

74. Changes to existing tax treaties are required to implement the new allocation of taxing rights over a portion of a non-resident enterprise's business profits in the absence of physical presence and computed other than in accordance with the arm's length principle. The amendment of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS might also be explored to streamline the implementation of the changes in the tax treaty network.

Pillar Two - Global anti-base erosion proposal

75. While recognizing that jurisdictions are free to determine their own tax system, including whether they have a corporate income tax and where they set their tax rates, the Inclusive Framework has agreed, under pillar two, to explore on a without prejudice basis, an inclusion rule, a switch over rule, an undertaxed payment rule, and a subject to tax rule, applicable where income is taxed at an effective rate below a minimum rate. The implementation of the approach developed under this pillar would require the exploration of issues related to rule co-ordination, simplification, thresholds and compatibility with international obligations. The global anti-base erosion (GloBE) proposal seeks to address

remaining BEPS risk of profit shifting to entities subject to no or very low taxation since certain members of the Inclusive Framework consider that the BEPS Package do not yet provide a comprehensive solution to such risk. These members are of the view that profit shifting is particularly acute in connection with profits relating to intangibles, prevalent in the digital economy, but also in a broader context.

76. The scope of the global anti-base erosion proposal is not limited to highly digitalized businesses, recognizing, that it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes. Designed to ensure that all internationally operating businesses pay a minimum level of tax, the global anti-base erosion will help to address the remaining BEPS challenges linked to the digitalizing economy, where the relative importance of intangible assets as profit drivers makes highly digitalized business often ideally placed to avail themselves of profit shifting planning structures.

77. The proposal relies on two inter-related rules: (i) an ***income inclusion rule*** that would tax the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate; and a ***tax on base eroding payments*** that would operate by way of a denial of a deduction or imposition of source-based taxation (including withholding tax), together with any necessary changes to double tax treaties, for certain payments unless that payment was subject to tax at or above a minimum rate. According to the Programme of work, the Inclusive Framework plans to implement these rules by way of changes to domestic law and double tax treaties and would incorporate a co-ordination or ordering rule to avoid the risk of economic double taxation that might otherwise arise where more than one jurisdiction sought to apply these rules to the same structure or arrangements.

Income inclusion rule

78. The Work Programme would explore an inclusion rule that would impose a minimum tax rate. By virtue of this mechanism, a shareholder in a corporation will be required to bring into account a proportionate share of the income of that corporation if that income was not subject to an effective rate of tax above a minimum rate. This rule could supplement a jurisdiction's CFC rules. The Inclusive Framework is aware that a minimum tax tied to each country's corporate income tax (CIT) rate would result in a more complex international framework given the significant variance in CIT rates across its members. On the contrary, the work programme would explore an approach using a fixed percentage rather than a percentage of the parent jurisdiction's CIT rate or a range or corridor of CIT rates. It is contemplated that this rule would apply where the income is not taxed at least at the minimum level, operating as a top up to achieve the minimum rate of tax.

79. Using a percentage of the parent jurisdiction's CIT rate would give rise to significant variations in the rates used under the inclusion rule, which would not result in a level playing field and make it difficult to co-ordinate such a rule with the undertaxed payments rule, significantly increasing the risk of double taxation. The Programme of work considers that a fixed percentage tax rate would provide greater transparency and facilitates rule co-ordination, thereby reducing administration and compliance costs. It also helps maintain a level playing field for jurisdictions and taxpayers and reduces the incentives for tax driven inversions and other restructuring transactions.

80. The Inclusive Framework will explore simplifications to improve compliance and administrability for both taxpayers and tax administrations and to neutralize the impact of structural differences in the calculation of the tax base.

Tax on base eroding payments

81. According to the second element of the two-blended mechanism that the Programme of work proposes under Pillar two, source jurisdictions would protect themselves from the risk of base eroding payments through the following elements that will be explored by the Inclusive Framework: on the one hand, an **undertaxed payments rule** that would deny a deduction or impose source-based taxation (including withholding tax) for a payment to a related party if that payment was not subject to tax at a minimum rate; and, on the other hand, a **subject to tax rule in tax treaties** that would only grant certain treaty benefits if the item of income was subject to tax at a minimum rate.

Rule co-ordination, simplification, thresholds and compatibility with international obligations

82. To ensure the proposal avoids the risk of double taxation minimizes compliance and administration costs and that the rules are targeted and proportionate, the programme of work recognizes that further work will also be required on rule co-ordination, simplification measures, thresholds and carve-outs. This work will address the priority in which the rules would be applied and how they interact with other rules in the broader international framework, in particular, the interaction between this proposal and other BEPS Actions. Compatibility with international obligations (such as non-discrimination) will also be explored by the Inclusive Framework.

Next steps

83. For the following months, the Inclusive Framework will continue to work on the architecture of a unified approach under Pillar One and the key design elements of the GloBE proposal under Pillar Two so that a recommendation on the core elements of long-term solution can be agreed at the beginning of 2020 and a final report delivered to the G20 by the end of 2020.

(b) INTERNATIONAL MONETARY FUND;

Introduction

84. On March 10, 2019, the IMF released a policy paper called "Corporate Taxation in the Global Economy"[4] ("the paper"). The IMF Press Release accompanying the release of the paper is important context in that it conveys the reflections of the IMF Executive Directors on what is essentially an IMF Staff Paper. This note summarizes the paper and adds some additional commentary. The footnotes were created as part of this summary, and are not IMF or IMF staff-created.

85. The Press Release accompanying the paper is important in contextualizing the paper and acknowledging some of the differing views amongst the Executive Directors of the IMF on some of the issues. The Press Release notes that: "[t]he paper does not endorse any specific proposals for international tax reform. It recognizes that views differ widely. Rather the paper identifies and discusses potential criteria by which alternatives might be assessed - with special attention to the circumstances of developing countries - and provides some empirical analysis to support discussions."[5]

[4] https://www.imf.org/en/Publications/Policy-Papers/Issues/2019/03/08/Corporate-Taxation-in-the-Global-Economy-46650

[5] IMF Press Release No. 19/69, March 10, 2019, p. 2.

86. As to the broader background of global developments, the press release continues with the assessment of the Executive Directors, clearly reflecting the aforesaid differences of approach or emphasis:

> [IMF Executive] Directors welcomed the significant progress made in addressing corporate tax avoidance and enhancing multilateral cooperation, notably by the G-20/OECD project on Base Erosion and Profit Shifting, and the Inclusive Framework that has broadened the scope of cooperation to many non-OECD countries. At the same time, they noted that there remain shortcomings in current international tax arrangements, and that many countries face pressures to introduce unilateral action. Directors agreed that much remains to be done to find sustainable global solutions, building on the progress achieved so far to ensure fairness, inclusiveness, and broad consensus, although their views differed on the extent of needed reforms and the roles of relevant bodies.
>
> …
>
> Directors noted that views on the relative merits of alternative reform proposals vary to a great extent. They emphasized that much depends not only on the detail of specific proposals and their implementation but also on the relative importance attached to the various assessment criteria. Noting the tentative nature of the staff assessment, Directors stressed that it should be interpreted and communicated with caution. While Directors considered it too early to endorse any of the alternatives, they found the discussion a useful analytical complement to existing debates. Specifically, many Directors saw the benefit of minimum taxation in dealing with harmful tax avoidance and profit shifting practices. Directors emphasized that, to better inform the ongoing debate, considerable further analysis of the reform proposals is needed with respect to legal issues, practical consequences, including distributional effects, and implications for various groups of countries with similar or unique characteristics.
>
> Directors underscored the need for an inclusive process for discussing international taxation, especially as fundamental issues in the allocation of taxing rights come under discussion. Many Directors felt that the current governance arrangements, with the OECD as a central body and standard-setter and supported by the Inclusive Framework, are broadly appropriate.
>
> At the same time, many Directors saw room for improvements, including to enhance the representation of developing and low-income countries in the decision-making process.
>
> …

The Report

87. In the Report itself, a number of the approaches considered when it was drafted (January 2019) reflect the proposals now being considered before the Inclusive Framework, and some alternative approaches are also addressed.

The Situation as at January 2019

88. The paper recognizes positive developments as part of the G20/ OECD BEPS process but notes also the remaining vulnerabilities, including[6]:

- Outdated *nexus* requirements (chiefly a reliance upon concepts of physical presence);
- Uncertainties in *allocation* of taxing rights, including conceptual and practical difficulties in applying the Arm's Length Principle;
- A substantial scope for profit shifting, which is unlikely to diminish;
- The limitations of the "*value creation*" concept as a basis for addressing nexus or allocation issues - "The call for taxation 'where value is created' has proved an inadequate basis for real progress";
- That the BEPS project and other recent multilateral initiatives have focused on tax avoidance rather than what is arguably an even greater concern: persistent tax competition;
- That, with the focus of current activities being heavily on harmful tax practices (preferential treatment to firms without economic substance) potential tax savings may be so great that resources are simply allocated as are needed to meet "substance" tests and there may be tax competition among countries to attract "real" investment; and
- The need to better address the needs, capacity constraints and the costs of complexity in policy design and administration, of developing countries and to address their difficulties in assessing implication of proposals.

The Digitalization Debate

89. The IMF paper recognizes that if there has been any consensus in the G20/OECD work in this field, it is that "attempts to isolate for special treatment a 'digital economy' (or 'digital activities') are misplaced, given how pervasive these technologies are, and so unpredictable is their future development."[7] It notes as the implication flowing from this that measures seeking to 'ring-fence' a subset of firms or activities would be inappropriate.

90. The paper also recognizes, however, that policy in many countries has moved rapidly in the direction of short-term measures while the search for a common approach continues at the OECD[8]. In relation to this trend, it takes the view that:

- For some countries, targeted action, pending a longer-term solution, appears to be a political imperative given domestic views of under-taxation;
- For others, digitalization requires little change in current arrangements;
- Some see proposed and enacted measures as merely a grab for revenue from a few prominent and largely U.S. owned companies; and

[6] Pp 8-10.
[7] P. 14.
[8] Pp. 14-17.

- Others see the challenges of digitalization point to the need for a fundamental reformulation of international tax arrangements.

91. The IMF paper concludes that the principal argument used for departing from current international tax norms (based on physical presence for a certain period) norms relates to cases in which user participation is inherent to the value of the product itself, with the act of consumption providing some input that is fundamental to the commercial premise of that model:[9]

> By searching, for instance, they provide information that can shape advertising; by posting on social media, they provide content that attracts other subscribers. Through such "user participation"', they are "co-contributing to a business' offering." This then is seen as a form of productive activity, akin to that traditionally associated with a physical presence, that should create a right to tax in the country of the user but under current rules does not. Those rules, on this view, therefore need adjustment, accepting this would be a fundamental departure from current norms.

92. The paper goes on to recognize, however, that "[a] considerable problem with this approach is how to distinguish cases where users create value from those in which they just consume".[10] It continues:[11]

> "Implementation raises practical issues - in defining precisely when the right to tax arises, and the income that then becomes taxable. These will be hard to resolve without addressing a more fundamental point: so pervasive is the use of (potentially monetizable) information generated by users - that is sent back to the manufacturer by users of motor engines, for example, or of fridges - that drawing the line between cases in which users are and are not contributors is inevitably fraught. This makes attempts to 'ring fence' particular activities in this way highly problematic. While the underlying argument is based on users as generating value, and so akin to a source-based claim, the wider the view taken of contribution, the more the system resembles one that more generally attributes taxing rights to the destination or "market" jurisdiction - a direction of reform explored below."

93. The paper identifies as a differing and less widely heard argument the approach that taxation related to digital business models is in effect targeted to particular sources of location specific rents.[12] The paper draws analogies between the information about themselves that consumers provide when, for instance, they use a search engine, and the extraction of a country's natural resources.[13] if the users were selling the information about

[9] P. 15.
[10] P. 15.
[11] P. 15.
[12] P. 15.
[13] P. 16.

themselves, their earnings would be taxable where they reside; but where they are not explicitly remunerated, those earnings are implicit in those of the firm exploiting the information, on this approach.

94. The paper analogizes data to oil and says:[14] "[j]ust as the rents associated with natural resources are seen as a proper object of taxation where they are located, so might be the rents associated with information about a country's residents. The analogy with natural resources is not seen as exact: information is not a rival good[15], whereas oil is. But there are similarities: both are excludable, both might be seen as collective national assets,[16] and just as the value of crude oil increases as it is refined and processed, the value of raw data increases as it is refined by algorithms and analytics. And critically, both are unique to a particular location. The paper concludes that valuation issues may be greater in relation to information (though they are not always trivial in relation to resources); but this raises issues of practice rather than principle.

95. It is no surprise that the paper recognizes that implementing these approaches to taxing income associated with digital-heavy business models would require significant changes to current norms and pose new challenges for administration and compliance, making it an option only for the longer term. It identifies the following as necessary to such changes:[17]

- Establishing a right to tax even when the multinational group has no resident entity or permanent establishment - some form of 'virtual permanent establishment' - which requires reformulating double tax agreements;
- Rules for allocating the income to be taxed, based on allocation of residual profit according to user participation or otherwise; and
- Information not just as to taxpayers without physical presence but as to the volume of users, appearance of adverts or the like – information not currently collected by tax administrations. The report indicates that such information would need to be self-reported, possibly with trusted third-party verification.

96. In the current absence of a new international architecture, the report addresses moves in some countries towards Digital Services Taxes ("DSTs")[18] and recognizes a common feature among them of taxing turnover from specified activities rather than income. It sees this as in part reflecting the difficulty of identifying associated costs, but also as presumably intended to keep these taxes beyond the scope of tax treaties. It indicates further, however, that the "data as oil" analogy, as noted above, "suggests a more positive view of turnover taxation, as analogous to the royalty that resource countries might wish to impose, whether as an imperfect substitute when direct taxation of rents is difficult, and/or as a *de facto* export tax to exercise market power that the individuals about whom information is extracted cannot assert individually."

97. The report considers that the efficiency effects of digital services taxes are not clear cut.[19] With its appearance as a turnover tax, such a tax is likely to be passed on to some

[14] P. 16.
[15] I.e. a good that can only be possessed or consumed by a single user.
[16] It is important to note that in treating such data as a "collective national asset" that does not imply what would be a very politically difficult concept that consumer information is state property.
[17] P. 16.
[18] Pp. 16-17.
[19] P. 17.

degree in the price of the taxed service. If the service, such as advertising, is itself used as business input then this becomes a potential source of production inefficiency.

98. There are important qualifications given to this assessment, however:[20]

- If the marginal cost of providing the taxed service is low, then the digital services tax acts like a tax on the firm's quasi-rents: rents that are exclusive of costs sunk in establishing the business. The primary impact may then be not on current pricing but on future investment; and
- The "user participation" under consideration as one form of nexus test means that the digital services tax applies in contexts with features of 'two-sided markets' in which incidence effects are complex.

99. The paper notes the significant potential revenue from digital services taxes is significant, but also that their efficiency effects remain unclear.[21]

100. The paper recognizes the political pressures to introduce some form of digital service tax are strong in many countries - but also that their uncoordinated proliferation creates complexity and jeopardizes tax cooperation.[22] The risks of disputes and double taxation are acknowledged and the paper describes as "troubling" that divergent approaches mark a major departure from the incomplete but significant progress that the BEPS project has made in taking forward thoughtful multilateralism in international tax matters.[23]

101. to deciding where exactly that is.[24] It sees an increasing recognition that the arm's length principle does not fully resolve the issues. It concludes that none of the proposed solutions to the perceived problems from digitalization would deal with profit shifting and tax competition.[25] It sees this dynamic as part of wider developments and notes that, while the general principle that tax be levied where value is created readily attracts agreement, views can differ widely when it comes

Some Additional Notes on the Issues Raised by the Paper

(a) Which taxing norms are we talking about?

102. In reading the IMF paper some clarifying observations may be made on the paper beyond what is contained in the paper itself. These follow, and should not be attributed to the IMF or its staff.

103. First, in referring to changes in international tax norms, there are actually two levels of relevant norms. At domestic law, there is already a very broad right to tax consistent with the norms of international economic law[26] although this needs to be in accordance with international obligations otherwise incurred, such as WTO obligations, of course.

[20] P. 17.
[21] P. 17.
[22] P. 18.
[23] P. 18.
[24] P. 18.
[25] P. 18.
[26] Issues may arise of extraterritoriality in some cases, but jurisdiction is exerted by many countries in many cases for activities sufficiently related to a country's own territory, whether because it is not regarded as an

104. In cases where there are no treaty restrictions on domestic law taxing rights (and these cases are common for developing countries) there are not existing the same bilateral treaty-based *jurisdictional* restrictions based upon geographical or physical presence – any restrictions will essentially be those under domestic law and other treaty obligations (such as WTO and investment treaty obligations).

105. There may still be issues of enforcement and of double taxation, as well as of frictions between countries as a result of asserting jurisdiction untrammeled by tax treaties, of course.

106. It follows that, when reference is made to a "fundamental change of principle in extending taxing right to destination or 'user' countries"[27] or "taxing rights being established"[28] as with the OECD/IF Workplan reference to the proposed reallocation of treaty taxing rights as "the new taxing right"[29], it is worth bearing in mind the outcome of discussions at the global level will not result in provision to countries of a taxing right that they do not already have at domestic law – there is no "negotiated gift" of such a right. It may make it easier to enforce such rights internationally – to the extent allowed by any consensus – and may extend in some respects the current treaty allocation of taxing rights but it does not create a new taxing right per se.

107. Treaty relationships (including whatever the treaty implementation of any consensus is) do not create taxing rights, but only allow or deny their exercise in the context of the treaty relationship. What would happen is that treaty relationships based on a successful consensus solution would reallocate the taxing rights between countries party to it in a way differently than has traditionally been adopted, with in some respects a departure from traditional geographical presence rules for affected cases. To avoid double taxation, there would need to be provision for credits or exemptions where taxing rights are not allocated to one country exclusively.

108. This would in practice restrict the exercise of full domestic taxing rights for the duration of the treaty relationship between treaty parties, for the mutual benefit of avoiding double taxation and the dampening effect this may have on investment for development. In some relationships between countries, where a treaty based on geographical presence exists, there will be more taxation rights exercisable by the source country than before.

109. In cases where there was no such treaty relationship, the source country would be reducing its possibilities for source taxation, though it may regard this as acceptable on the basis that (a) a fair allocation of source taxing rights is given under the consensus (b) the consensus recognizes the developmental benefits of giving greater certainty to taxpayers and avoiding double taxation and (c) it avoids disputes between countries that may occur, including at the political level, or in other for a such as the WTO if reliance is put only on non-consensus-based domestic law measures – especially as smaller countries may feel they are less likely to "win" such disputes under current conditions. The following represents a tabular representation of this:

extraterritorial assertion, or it is, but is regarded as an acceptable such assertion as sufficiently affecting the interests.

[27] At para. 92.

[28] At para. 92.

[29] At para 23.

	Countries are in a Treaty Relationship	***Countries are not in a Treaty Relationship***
Current (pre-consensus)	Governed by treaty – PE status governed by geographical/ time-based rules, but UN style Services PE and Fees for Tech Services provisions may be relevant (and therefore a consensus will need to consider their future) **Pros:** Relatively known in operation **Cons:** Not well adapted to digitalized economy – lacks public confidence	Depends – as to jurisdiction - on domestic law (existing and as introduced later) . Few restrictions, and any are likely to be based upon treaty relationships (e.g. trade and investment treaties) rather than some concept of customary international law. **Pros:** Maximum flexibility in legal terms to ensure fair tax outcomes (especially over time as business models develop). **Cons:** Possibility of double taxation and tensions between countries. Smaller countries may find it difficult or impossible in practice to exercise enforcement jurisdiction, and uncertainty may affect investment climate.
Post-consensus	Defined by nexus rules and allocation rules in new treaty/ arrangements **Pros:** A degree of consensus is manifest in the resulting treaty relationship – disputes should be limited and not play out at the political level. **Cons:** May still be disputes about interpretations and application – country may feel less control over interpretations than in a purely bilateral relationship (there may be "peer" interpretations and there may be only a limited confidence in dispute settlement provisions (such as third-party arbitration – may be certainty of a result but not necessarily the right one); The degree of confidence in (1) the "interpretative documents" (for Vienna Convention purposes) surrounding any consensus (such as Explanatory Memoranda and Commentaries) and the drafting of them and (2) the dispute settlement mechanism and decision makers under that system, will in large part determine the extent of confidence in countries as to what has (in practical terms) been agreed to – their own technical analyses will be less systemically important. Possibilities that taxpayers will be able to "work around" the treaty provisions, and receive the benefits of the consensus without the expected burdens.	The **pros and cons** are, for non-participants in any consensus, as for the above, except that (depending on the breadth and depth of consensus) it: (1) would exacerbate the risk of double taxation; (2) would make it harder to propose different provisions in bilateral treaties in future – especially to those countries that have joined in the consensus or whose domestic legislation is aligned with it; and (2) may be difficult (especially for smaller countries) to resist participation in any case, particularly if elements of the consensus become a "minimum" standard for participation in elements of the international tax system which are important to it, or which it otherwise feels it must participate in. There is also a risk that, rightly or wrongly, new consensus standards will be widely viewed as impacting on what is acceptable domestic taxation, even in the absence of a treaty relationship.

(b) Is unilateral action being unnecessarily demonized?

110. One other issue that is not discussed to any real degree in the paper or elsewhere is the role that unilateral approaches, have sometimes played in suggesting ways ahead for the BEPS project (such as the modified nexus approach under Action 5, drawing upon UK patent box experience) and indeed this part of the project, Action 1, which is drawing upon US legislative experience such as the GILTI and the BEAT, quite extensively.

111. Unilateral measures sometimes tend to be demonized ab *initio* by comparison to an agreed multilateral outcome, because they are compared with the notional perfectly harmonious outcome that are willingly entered into by countries as a result of policy agreement and goodwill rather than a sense of pressure to agree. It follows that the helpfulness or otherwise of unilateral measures can only be judged in the context of the readiness and likelihood that multilateral approaches will in the deepest sense "succeed".

112. There is a concern in some areas that some countries could seek to bend the multilateral consensus to their preferences, thereby limiting the actions of other countries, but then may not join the consensus in any case. Of course, in such a case (in the absence of a broadly applicable minimum standard that applied in relation to both treaty and non-treaty partners) they would not benefit from the treaty outcome, but they would have shaped the global rules in their own current image and received that benefit without having attendant obligations.

113. Many of the BEPS measures have drawn on or legitimized the unilateral measures of developed countries in particular, and many developments in the UN Model such as the 2017 Fees for Technical Services provision (the place of which in the proposed consensus is rarely discussed) are drawn on unilateral legislation in countries then "bilateralized" by the right being preserved in treaties.

114. While unilateral measures should not impede any progress to a truly consensus agreement, the view of some countries can be understood as supporting consensual solutions (by for example, an understanding that they will yield to such a solution) encouraging their rapid conclusion while responding to the calls of their citizenry for immediate action. Digital Services Taxes and other unilateral measures and elements of them such as withholding tax approaches, might, at least in principal, comprise a rich a rich vein of solutions for multilateralization rather than a simple portent of chaos.

115. Obviously, a key is whether such unilateral measures are likely to encourage a result that can attract a genuine consensus rather than discourage a consensus that might otherwise be in reach. If the view of enough countries remains that a sufficiently acceptable compromise (acceptable to developing countries as well as developed, and to both smaller and larger markets) is not within reach, then some form of unilateral measures will be inevitable, and on one view, preparing oneself for that possibility – while seeking to minimize differing formulations where the same policy result is sought, and providing transparency about the approaches taken by countries, promotes the greatest achievable certainty for all stakeholders in an imperfect world.

116. It is again stressed that a proliferation of unilateral measures persisting over time is inherently sub-optimum, but that is neither to say that they may be the best interim option for some countries, parallel with multilateral discussions, or that they might not be preferable for certain countries to multilateral options that do not sufficiently take account of their situations, even taking account of the tension this may cause (whether it is ultimately creative or destructive) and the inherent limitations in less powerful countries asserting the unilateral jurisdiction.

117. In assessing these issues, it should also not be assumed that a situation that appears better than the current situation for countries that may not assert taxing jurisdiction yet is because of that fact alone a good result for such countries. The right form of stability and certainty (never total) is sought , rather than stability and certainty lacking the qualitative assessment.

118. Any multilateral conclusion on these issues will likely endure for many years and a fair evaluation of its benefits for countries and taxpayers should extend into that future and be compared with other possible options even if they are not yet widely in place.

Alternative Architectures

119. Returning to the specific terms of the IMF paper, it then goes on to address various "alternative architectures" or "alternative futures" as follows:[30]

(a) Evaluating Alternative International Tax Systems

120. As noted above, the IMF paper sees the BEPS objective of **"taxing where value is created"** as, at best, an incomplete standard by which to assess international tax arrangements, only really well adapted to cases of aggressive tax planning or tax avoidance.

121. More fundamentally, the paper considers that whenever value is the product of several contributions, there is no unambiguous way to express that value as the sum of distinct contributions. From an economic perspective the approach leaves open the possibility of distortions arising from differences in tax treatment and of collectively damaging competition to attract the 'value-creating' activities. This tax competition angle is an important one in the paper as a whole.

122. **Economic efficiency is another common thread in the paper,** and it considers that efficiency requires that rents - receipts above the minimum return required by the investor - be taxed somewhere. It notes that many sources of rent (related to company-specific knowhow, for instance) could be generated from alternative locations, so cannot be taxed by a country without

123. Some fear of driving their generation elsewhere. There are some rents, however, specific to particular locations - most obviously those associated with natural resources; and the paper advises that deploying rent taxes in the extractive industries is a standard IMF recommendation.

124. While the paper recognizes that even with location specific rents, the practical difficulty arises that standard avoidance techniques can be used to relocate their apparent source across jurisdictions, it finds few other robust principles for efficient international tax design, and therefore takes what it calls "a more pragmatic focus on identifying particular distortions."

125. With this context, the paper considers various dimensions of **desirable tax neutrality**:

- between alternative locations for outward investment (capital export neutrality (CEN));

[30] P. 18.

- between alternative sources of inward investment (capital import neutrality (CIN)); and
- in the ownership of domestic assets (capital ownership neutrality (CON)).

126. However, it recognizes that it is impossible to ensure all three of these neutralities without fully harmonized tax systems, and failing that, there are no clear-cut results as to the relative importance of each.

127. The paper therefore proposes to focus more pragmatically on specific instances of tax considerations dominating commercial ones or distorting competition.

128. The paper takes the view that there is little agreement on standards of **inter-nation equity**[31] -other perhaps than the allocation of taxing rights over location specific rents to the jurisdictions in which they arise. It notes that the case for allocating taxing rights over location specific rents to the location country seems widely accepted - though it recognizes that putting this concept into legal language is challenging.

129. While the paper regards it as a "given" in what follows that source countries are to retain substantial **taxing rights in relation to natural resources**. Beyond this, however, it refers to a "longstanding **tussle for taxing rights between 'source' and 'residence' countries** - a critical issue for low income countries, which are primarily 'source' countries."

130. It notes an **increasing blurring of source and residence concepts** however, especially as it becomes harder to clearly identify where profits are created and as corporate residence becomes increasingly removed from economic fundamentals: the paper recognizes that corporate structures can, in particular, be arranged to establish residence.

131. The vulnerability of international tax arrangements to profit shifting and tax competition is addressed. The "spillovers"[32] these can generate relate most evidently to inter-nation equity, through their impact on the allocation of tax revenues across jurisdictions. Both, the paper indicates, raise efficiency concerns too:

- Companies may, for instance, move real resources inefficiently in order to exploit profit shifting opportunities; and
- There is potential inefficiency in terms of governments' financing decisions: by reducing tax revenue, these spillovers ultimately create a need to either deploy other tax instruments that are more distorting (or inequitable) or cut public spending.

[31] [Additional note] See, for a discussion of Inter-nation equity in the context of tax on the digitalized economy (and a tribute to one of the founders of the concept, the late Peggy Musgrave) see Allison "Christians, Digital Services Taxes and Internation Equity: A Tribute to Peggy Musgrave", *Tax Notes International,* 12 August 2019. As to the meaning of the term, see Li, Jinyan, "Improving Inter-Nation Equity through Territorial Taxation and Tax Sparing" (2009). All Papers. Paper 252. http://digitalcommons.osgoode.yorku.ca/all_papers/252, at p.4 (citations not included):

> "Peggy Musgrave adopted the term "inter-nation equity" in her work published in the 1960s. In United States Taxation of Foreign Investment Income (1969) she writes that "international revenue sharing, as an aspect of the taxation of foreign investment, is a matter of inter-nation equity", and that "[a]lthough this problem is of little interest to the private investor, it is a major concern of the countries involved…" Over the years, internation equity has been variously described by Peggy and/or Richard Musgrave as an "equitable division of the tax revenue between countries," "the problem of tax shares in international business," and an equitable "allocation of national gain and loss."

[32] [Additional note] As to which, see for example IMF Policy Paper, "Spillovers in International Corporate Taxation" 9 May 2014, https://www.imf.org/external/np/pp/eng/2014/050914.pdf

132. The **importance of the corporate income tax** to low income countries and their greater

133. vulnerability to profit shifting is seen as warranting special attention. The paper recalls that lower income countries tend to be more reliant on the corporate income tax as a source of revenue than are other countries, and any reduction in their corporate income tax revenue may be hard to replace:, the VAT in many cases is already under stress, the personal income tax remains weak and reliance on trade taxes is already high.

134. The paper recognizes **ease of administration and compliance** as key concerns, and as closely related to assuring certainty in tax matters. The considerations here are identified as broadly the same as in other areas of taxation, including for example, **the simplicity and clarity of obligations, the scope for self-assessment, the ability to identify taxpayers, and the ease of verification and enforcement.**

135. The paper also recognizes ease of legal implementation as a criterion for evaluation, principally by taking into account the effect that existing legal commitments can have on the viability of the proposed reforms, in terms of:

- hard law of (in particular) double tax agreements, WTO rules, and EU law, or
- softer rules, such as such as BEPS minimum standards and other agreements.

136. The paper opines that evaluation of a scheme may be quite different depending on whether its adoption is multilateral or unilateral, with some schemes eliminating profit shifting if adopted globally but exacerbating it if adopted unilaterally.

(b) Minimum Tax Schemes

137. The paper notes[33] that proposals for imposition of a minimum level of taxation are gaining traction globally, including various approaches relating to either inbound or outbound investment taxation. The paper recognizes that minimum taxes can be used to address profit shifting, especially for developing countries, but it notes also their administrative complexities and a lack of global consensus on them.

138. The paper outlines various *outbound* minimum tax measures and discusses their limitations as well as the impact on source countries. These include Controlled Foreign Company (CFC) rules and the United States Global Intangible Low Taxed Income (GILTI) provision.

139. As to measures for minimum taxation of *inbound* investment, the paper describes the US Base Erosion Anti-Abuse Tax (BEAT) measures, which are influential in the current Pillar Two discussions in the Inclusive Framework.

140. The paper concludes that some form of **minimum tax on inbound investment** is especially important for developing countries, since they are rarely the country of a headquarters, but a place of investment. The summary evaluation is that: “Minimum tax schemes can be powerful in addressing profit shifting, and can dampen tax competition. They face relatively modest legal impediments, though administration can be complex. On inbound investment, they can be especially appealing for lower income countries”[34]

[33] P. 21.
[34] P. 25.

(c) Border-adjusted Profit Taxes

141. The paper discusses a border-adjusted tax (or some form of destination-based taxation[35]), which taxes imports but not exports, so that goods are taxed in the destination – where they are "consumed". The issue of where a company is based does not matter, but where its products are sold *does* matter. Tax deductions would also not be allowed for imported products used in producing exported profits.

142. In other words, such a tax allocates taxing rights to the country where the purchaser is located. The paper describes a **destination-based cash flow tax** (DBCFT) as combining border adjustment with cash-flow treatment that involves immediate expensing of investment without interest expense deductions. The paper considers that raising value-added tax rates and lowering wage taxes would have effects like such a tax.

143. While taking the view that, if universally adopted, this form of tax would eliminate profit shifting and tax competition and would not affect international trade, the paper further notes that [in what is a far more likely scenario[36]] partial adoption of such tax could create profit-shifting pressures on the non-adopting countries.

144. While generally more favourable to a destination-based cash flow tax than many other authors have been, the paper recognizes that there are significant legal issues associated with the destination-based cash flow tax, due to potential inconsistencies with:[37]

- *WTO rules* - despite its being economically equivalent to a VAT plus wage subsidy, each of which is WTO-compatible. The paper notes that views differ as to whether a destination-based cash flow tax could be drafted to avoid this risk; and
- *Double taxation agreements* - which absent physical presence do not allocate any taxing rights to the country of the final sale. If the destination-based cash flow tax were held to be within their scope, double taxation agreements would need amending.

145. The paper also considers a destination-based allowance for corporate equity, which is a system that retains interest deductibility but provides a deduction for a notional return on equity. This is seen as a way of reducing base erosion by profit shifting and voiding some of the transitional issues of a destination-based cash flow tax, but possibly serving as a step towards it. The paper asserts that such a system would help reduce base erosion from profit shifting as well as tax competition pressures, without removing them.

146. The summary evaluation accordingly is that:[38] "Universally adopted, the DBCFT is robust against profit shifting and tax competition; adopted unilaterally, it can aggravate both. Implementation can draw on experience with the VAT, but there are significant legal questions such as those relating to consistency with WTO rules and double taxation agreements. Implications for developing countries remain unclear, but, with source taxation retained for natural resources, these are not necessarily adverse."

[35] P. 25 ff. On the destination based cash flow tax, at one point discussed as a possible option for the USA, see Auerbach, Devereux, Keen and Vella, "Destination-based Cash Flow Taxation" (2017) https://eml.berkeley.edu/~auerbach/CBTWP1701.pdf. Michael Keen was also a key author of the IMF paper.
[36] Editorial note.
[37] P. 30.
[38] P. 31.

(d) Formulary apportionment

147. The paper considers the consolidation of all company affiliates into a single tax base that is then apportioned across jurisdictions according to a prescribed formula.[39] It notes that this approach has been used, in some form, for some time for sub-national taxation in the US, Canada, Japan and Germany.[40] It addresses some of the literature on the issue and considers some of the factors which had been advocated as part of the formula (which can accord differing weightings) in the following terms:[41]

- ***Production factors.***
    - Payroll, employment and assets are commonly used.
    - Payroll would be difficult to misrepresent, and much labor is relatively immobile.[42]
    - For tangible assets, valuation can be non-trivial but there are commonly used methods; they (and some skilled labor) are though relatively mobile, so that differences in tax rates across jurisdictions will distort their allocation.
    - Intangible assets are usually excluded because they are hard to value and relatively easy to relocate; to the extent, however, that intangible assets

[39] P. 31ff.

[40] Spencer notes that formulary apportionment based on a separate entity approach, or that it be applied to those companies in a group that are carrying on a "unitary business. He also opines that the paper gives little detail to the theoretical and practical problems of formulary apportionment. His article gives views on some of the perceived deficiencies of available formulary apportionment options, David Spencer, "The IMF Policy Paper: Formulary Apportionment as the Alternative International Tax Architecture (Part 1)", *Journal of international Taxation*, June 2019, 29 at pp.30-31.

[41] Pp. 32-33.

[42] *In its response to the IMF Report (Mark Bou Mansour, "*IMF support for radical overhaul of international tax rules welcomed by Tax Justice Network", March 10, 2019, https://www.taxjustice.net/2019/03/10/imf-support-for-radical-overhaul-of-international-tax-rules-welcomed-by-tax-justice-network/ *) the Tax Justice Network welcomed the re-consideration of the arm's-length approach which they saw in the IMF paper:*

> *"The IMF has stressed that international tax rules should be reformed to prioritize reducing the glaring inequalities that lower-income countries face when it comes to their taxing rights. We also welcome the IMF's support for replacing the arm's length approach with unitary taxation and formulary apportionment, so that tax is paid where real business happens – not where profits are surreptitiously shifted to. As the IMF report says, this 'would greatly reduce the scope for profit shifting'. The IMF's research confirms that if multinationals were to be taxed in line with where their employees actually work, developing countries would see their tax revenue rise by over 30 per cent on average, with the greatest benefits for smaller and lower-income countries.*

The TJN would have preferred more consideration of employment as a factor. Employment is usually considered in terms of numbers of employees – often considered to favour developing countries – whereas payroll is weighted to salaries, which usually favours developed countries. The TJN notes:

> *"It is odd though that the IMF seems cautious about including employment in the formula for taxation – despite its own analysis. That they even contemplate a destination-based cashflow tax (DBCFT) – which is a different way of allocating tax base on the basis of sales – suggests that they have not considered the development implications seriously. Since the idea was briefly raised to prominence in Trump's US tax reform debate, it has been savaged for reasons of practicality as well as the likely impact in exacerbating inequalities both within and between countries. On this, we suggest the IMF think again."*

derive from employment (R&D workers) or tangible investments (such as laboratories), they are captured by those other factors.

- If desired, proxies could also be used in the formula for the value generated by the users of digital services and platforms, although how to best measure this remains unsettled.

- ***Third party sales*.**
  - These can be measured on either an origin basis (location of the seller) or on a destination basis.
  - Apportioning on the latter basis has several of the advantages of destination-based taxation discussed in the paper, but risks arise in the formula apportionment context through the channeling of sales through low-margin unrelated firms based in low-tax countries.

148. The paper argues that formulary apportionment could reduce profit shifting and could provide an approach for assigning taxing rights. While it notes the potential of moving to such an approach to eliminate the difficulties in applying the "arm's-length principle", it recognizes of formulary apportionment may not reduce, and may even heighten, tax competition over location decisions. It looks at costs and benefits of formulary apportionment, including noting the challenge of agreeing a formula that suits developing as well as developed countries[43], and of reaching consensus on the tax base to which the formula would be applied.

(e) Residual profit sharing

149. Once routine profits are allocated for taxation purposes where the associated costs are incurred, the question remains as to how "residual profits" are allocated. The paper notes that this could be done by a formula. Countries may then choose to tax these two elements, potentially at different rates.

150. The IMF staff paper notes the broad variation of proposals in this area, and the limited consideration of impacts of the various proposals on developing countries. The paper notes the possible role of residual profit allocation approaches in eliminating profit shifting, but notes that they do not necessarily address tax competition. Additionally, the paper notes that little thought has been given to the implications of residual profit allocation approaches for developing countries.

Central Messages

151. The paper has some key messages:

- Digitalization issues are central to any discussions on the future of international corporate taxation;

[43] Spencer takes the view that "Global formulary apportionment does not provide the 'ease of administration and compliance, 'nor the 'assuring certainty on tax matters' which the IMF policy paper asserts are key concepts", citing difficulties in audit, increasing dependence on multinational accounting firms, and the need for complex adjustments, , David Spencer, "The IMF Policy Paper: Formulary Apportionment as the Alternative International Tax Architecture (Part 2)", *Journal of international Taxation*, July6 2019, 39 at p.41.

- The two central features widely associated with digitalization - less need for physical presence to do business and, in some business models, unremunerated acquisition of information from customers - are not inherently new; and
- They are, however, becoming far more pervasive and important, suggesting a need for action.

Governance of the international tax system and the role of international financial institutions

152. The IMF paper considers that any fundamental change in the international tax architecture, such as the alternatives discussed, would require levels of consensus that are probably unprecedented in this field. It notes the uncertainty that unilateral action can cause, including elevation to a political level, the possibility of double taxation including creation of distortions in general, possible conflicts with WTO obligations and souring international tax relations. The paper itself explicitly avoids seeking to identify solutions that will avoid this uncertainty while carrying sufficient consensus and constituting a good result for developing countries in variant situations.

The Attachments to the Paper

153. The IMF paper has a series of attachments at the end of the paper which are often important to the paper's argument and address some of the economic theory in more detail. These are as follows:

I. Consultation

154. This attachment indicates the consultations undertaken in preparing the paper.

II. The International Tax Framework - Core Elements and Concepts

155. This attachment outlines key elements of the international tax conceptual framework.

III. Multilateral Measures - BEPS and ATAD

156. This attachment explains in short form the BEPS outcomes, including the so called "minimum standard" and comparing those outcomes with the EC Anti-Tax Avoidance Directive of 2016.[44]

IV. International Provisions of the TCJA

157. This attachment gives a very short summary of tax provisions in the US Tax Cuts and Jobs Act of 2017 – those provisions are principally:

1. the ***'Global Intangible Low Taxed Income'*** (GILTI) with its minimum tax on overseas income;
2. the ***'Foreign Derived Intangible Income'*** (FDII), which effectively reduces the corporate tax rate from 21 to 13.125 percent for income arising from the sale of

[44] As to which, see https://www.consilium.europa.eu/en/policies/anti-tax-avoidance-package/

goods or services that are produced in the U.S., but sold to non-U.S. parties, to the extent that such income exceeds 10 percent of tangible assets; and

3. the ***Base Erosion Anti-Abuse Tax*** (BEAT), which is a minimum tax in relation to inbound investment, applied to MNEs with annual gross receipts over US$500 million in the preceding 3 years and making cross-border payments from the U.S. to affiliates of more than 3 percent of their total deductible expenses. The payments targeted are those (such as interest, royalties, and management fees) commonly associated with profit shifting.

V. Profit Shifting: Evidence and Opportunities

158. This attachment has a useful summary of this issue as well as a useful table addressing the "BEPS Impact on International Concepts and Norms for International Tax Law Design".

VI. Tax Competition

159. This attachment notes that:

- The BEPS and EU approaches focus on preferential tax treatment where there is no significant real nexus in a jurisdiction.
- Requiring countries to tax all activities, however mobile, in the same way can make tax competition even more harmful, because countries may choose, if prevented from setting differential rates, to switch from charging a high rate on less mobile activities and a low rate on more mobile ones to charging some intermediate rate on all activities. It notes that the spillover from the rate cut element of that may damage other countries more than the rate increase element benefits them.
- The BEPS minimum standard is consistent with this thinking in implicitly recognizing that differential treatment is not intrinsically harmful.
- Recently, the OECD have sought to overcome the potentially perverse [result][45] that a higher rate attached to a scheme which does not pass the nexus test would be harmful while a uniform very low CIT rate is not.
- Whether low or zero tax rates should be regarded as *per se* harmful is increasingly coming to the fore.
    - There would be some logic in doing so - so long as source-based taxes substantially determine overall liability - but also considerable conceptual, practical, and political obstacles.
    - Conceptually, any spillover effects from CIT choices need to be weighed against domestic considerations, which for some countries (such as those rich in natural resources) may reasonably point to low/zero general tax rates.
    - Practically, agreement would also be needed on tax bases to prevent low or zero effective tax rates being achieved by base narrowing. Politically, the choice of national CIT rates continues to be seen as a core aspect of national sovereignty.

[45] "Result" appears to be the missing word in this passage at p.58.

VII. Some Developments Concerning Developing Countries

160. This attachment addresses developments in 4 areas previously recognized as important for developing countries:

1. Double tax agreements (DTAs)
    a. The limitation of source taxing rights in most bilateral treaties is noted, with some ambiguity noted about countervailing FDI effects;
    b. The challenge is noted that, while countries are now increasingly seeking to adopt treaty anti-abuse provisions to counter treaty shopping, the question is how to best address it.
    c. The Multilateral Instrument (MLI) is noted as a potentially efficient way to modify existing treaties to do this, consistent with the BEPS minimum standard, by adopting safeguard provisions in the form of a principle purposes test (PPT) and/or limitation of benefits (LOB) provision.
    d. Under the MLI, however, the effectiveness of this depends on agreement with treaty partners, because of the reciprocal nature of any modifications.
    e. The report notes that, more generally, other problematic areas in developing countries' DTAs, such as maximum withholding tax rates, key elements of the PE definition and service fees require a separate process of renegotiation as they are not covered by the MLI.[46]
2. Taxation of capital gains on offshore indirect transfers of interest in assets (OITs).
    a. The report notes that this issue, which arises in relation to immovable property and potentially more broadly to telecoms, mineral and other licenses, relates to the potential for companies to avoid liability to tax on a capital gain associated with some underlying asset where that asset is located by realizing that gain through the sale in a low tax jurisdiction of a company holding that asset indirectly.
    b. Domestic laws and treaties of many developing countries need strengthening if they are to tax gains on OITs. The report notes the guidance in this respect of the Platform for Collaboration on Tax[47], and the presence in the MLI of a provision to make taxation of such gains more achievable in treaty cases (assuming the domestic law allows it)[48].
3. Interest deduction limitations
    a. The report notes that such limitations can usefully curb base erosion through debt shifting and are a standard recommendation in IMF technical assistance.

[46] Although the Report does not address the issue, the views taken on such issues often sharply differ as between the UN and OECD Model Double Tax Conventions, such as on Fees for Technical Service Fees provided to a consumer without a physical presence in the consumer's country.
[47] Drawing in part on some UN Tax Committee work as part of *the United Nations Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries* (2017): https://www.un.org/esa/ffd/wp-content/uploads/2018/05/Extractives-Handbook_2017.pdf
[48] The provision in question (article 13(4) was originally in the UN Model only. It was then introduced into the OECD Model and the provisions in the two Models (and of course the MLI) are now the same.

b. It notes that while a common approach is to use a debt/equity ratio to determine the proportion of interest that will be denied for deduction. BEPS Action 4 endorses a new approach based on an interest/earnings ratio.

c. The report notes that all thin capitalization rules, however, have an element of arbitrariness, potentially deterring investment because of their impact on non-abusive arrangements, and it gives some examples.

d. It notes that, more fundamentally, the problems of artificial debt shifting and perhaps debt bias are lingering ones.

4. Transfer pricing rules

a. The report notes the increasing use of transfer pricing regimes to address transfer mispricing, but also the complexity of such rules, with BEPS not reducing the complexity.

b. It notes that country-by-country (CbC) reporting - a BEPS minimum standard - could help LIC tax authorities in their transfer-pricing risk assessments, even though a transfer pricing adjustment cannot be based on a CbC report alone.

c. It recognizes that further information will still be needed (on, for instance, profit drivers, functional analysis, ownership structures, and intangibles) to apply ALP; and the skills to perform the corresponding audits are demanding.

d. It also addresses the issues some developing countries may face in meeting the required standards for data protection and other conditions for the exchange of CbC information if they are to be able to access CbC reports.

VIII. Digital Service Taxes: Enacted and Proposed

160. This attachment is a summary of the DST landscape at the time of the report (January 2019).

IX. Revenue Implications of Formula Apportionment

161. This attachment considers possible “winners and losers” under formulary apportionment (FA) and concludes that:

- Investment hubs stand to lose from FA, as they find their tax base significantly reduced under FA, whatever the formula used.
- At unchanged tax rates, global CIT revenue will rise under FA due to a reallocation of tax bases from low to high tax countries.
- The net revenue effect of shifts in the tax base to high-tax countries and cross-border loss consolidation is small. There are two offsetting effects. On the one hand, the smaller global tax base as a result of loss consolidation reduces global CIT revenue. On the other hand, the reallocation of the tax base from low-tax countries to high-tax countries increases it.

X. The Scale and Allocation of Routine and Residual Profits

162. This attachment combines micro and macro data to provide empirical evidence on the scale and cross-country distribution of routine and residual returns.

(c) AFRICAN TAX ADMINISTRATION FORUM;

Introduction

163. The Africa Tax Administration Forum (ATAF)[49] is a network of 36 African Tax Administrations with an aim of improving the effectiveness and efficiency of the administrations[50]. Despite the name, ATAF is concerned with tax policy issues as well as tax administration.

164. ATAF recognizes that African countries are faced by challenges in taxing the increasingly digitalized economies[51]. It regards this as due in part to the insufficiency of the existing international tax rules which require a physical presence, a 'nexus', in those countries where some multinational enterprises (MNEs) increasingly use business models minimizing physical presence.

165. ATAF has taken the view, in its first "Technical Note" on tax issues arising from digitalization[52] that the current nexus and profit allocation rules weigh heavily against "source" countries and therefore that it is not enough to revise the rules relating to digitalized business models only - the rules should ultimately and more systemically be broadened and revised to allocate appropriate taxing rights to market jurisdictions. ATAF indicated that while ensuring certainty to the taxpayer, the rules should be simple for tax administrations to implement.[53]

166. ATAF followed up that first technical note with two more technical notes, the second, entitled "Inclusive Framework proposals to address the tax challenges arising in Africa from the digitalization of the economy"[54] provided an overview of the proposals set out in the OECD/ Inclusive Framework Public Consultation Document titled "Addressing the Tax Challenges of the Digitalisation of the Economy" ("the Public Consultation Document").[55]

167. This second technical note is largely descriptive of the Public Consultation Document but also notes more broadly that:

- The African Union (AU) in its July Summit had endorsed ATAF as the lead technical advisory body for Africa on this work;
- The AU General Assembly called on ATAF to lead Africa's input into the global tax agenda work;

[49] ATAF is composed of Angola, Benin, Botswana, Burkina Faso, Burundi, Cameroon, Comoros, Cote d' Ivoire, Egypt, Eretria, Gabon, Gambia, Ghana, Kenya, Lesotho, Liberia, Madagascar, Malawi, Mauritania, Mauritius, Morocco, Mozambique, Namibia, Niger, Nigeria, Rwanda, Senegal, Sierra Leone, South Africa, Sudan, Swaziland, Tanzania, Togo, Uganda, Zambia, Zimbabwe.
[50] See https://www.ataftax.org/overview
[51] ATAF, "The tax challenges arising in Africa from the digitalisation of the economy" ATAF first Technical Note CBT/TN/01/19, ("ATAF") available at: https://events.ataftax.org/includes/preview.php?file_id=25&language=en_US
[52] Ibid ATAF, p.3
[53] Ibid ATAF, p.3
[54] https://irp-cdn.multiscreensite.com/a521d626/files/uploaded/Draft%20TN%2002%20%28003%29%5B1%5D.pdf
[55] https://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf

- ATAF already has a proven track record in influencing global standard setting through its Cross-Border Taxation Technical Committee (CBT Technical Committee), including during the BEPS process; and
- Africa will need to proactively participate in this work to ensure it influences the direction of the work and does not simply follow the outcomes decided by other countries, despite the challenges, including the technical complexity and short time frames.

168. The third in ATAF's series of Technical Notes on the tax challenges arising in Africa from the digitalization of the economy is entitled "Inclusive Framework proposals to address the tax challenges from the digitalization of the economy"[56] and addresses the OECD/Inclusive Framework Programme of Work (POW). It also gives ATAF views on the POW. This summary draws heavily on that note.

Issues Relating to Pillar One of the OECD/ Inclusive Framework Work Plan

Nexus Rules

169. As noted, ATAF observed in its First Technical Note that its members were dissatisfied with current tax rules, considering that they do not work well for Africa. ATAF further notes that the allocation of taxing rights favours residence jurisdictions where there is no or low physical presence in the source jurisdiction. In most cases the African countries are source jurisdictions. Consequently, tax bases are eroded due to illicit financial flows (IFFs) by MNE's artificially shifting profits, a risk that BEPS has not fully addressed. The Note indicated that this pillar "provides for an opportunity to consider simplification of the current transfer pricing rules which are extremely complex and fact intensive. African tax administrations often report to ATAF that these complexities in the rules make it extremely challenging to stems such IFFs caused by abusive transfer pricing practices".

170. At the ATAF High Level Tax Policy Dialogue held on 1st August 2019 in Zimbabwe, ATAF members further stressed in their Outcome Statement[57] the need to focus on discussing solutions to challenges facing Africa on the digital economy.

171. ATAF has taken the view, including in its Third Technical Note, that the new nexus rules should ensure that business activities include the value created by user participation. Changes effected through tax treaties should be dealt with in a new stand-alone provision rather than altering the permanent establishment Article in Model Tax Conventions and bilateral treaties.

172. ATAF also indicated the need to evaluate an MNE's remote but sustained significant involvement in an economy as well as that of the participation of "users" through the development of indicators of such engagement. This will mean MNEs are liable to tax on profits made in countries where they have significant sales or users without the physical presence requirement under the current rules.

173. ATAF observed, in its Third Technical Note, that any revenue threshold should not disadvantage small African economies by not allocating taxing rights to those jurisdictions because of the small size of their markets. In instances where absolute numbers are used, for instance a specific amount of sales, ATAF considers that low-income countries will be adversely impacted. For this reason, ATAF proposes that the threshold at which taxation can

[56] https://irp-cdn.multiscreensite.com/a521d626/files/uploaded/ATAF%20TECH%20NOTE%20ENG%20d2.pdf
[57] Available at https://events.ataftax.org/index.php?page=documents&func=view&document_id=42

occur should not be an absolute number (such as number of relevant consumers) but rather a relative factor to the size of the market - for example the *degree* of user participation.

174. ATAF has indicated no specific preference as between the 'user participation', 'marketing intangibles' or 'significant economic presence' approaches, presumably aware of the "unified approach being pursued by the OECD Secretariat in its drafting.[58]

Profit Allocation Rules and Transfer Pricing Aspects

175. ATAF has been, as noted, of the opinion that the current nexus and profit allocation rules weigh heavily against source countries and therefore it will not be enough to revise the rules relating to digitalization only[59]. The view was taken that existing rules should ultimately be broadened and revised to allocate appropriate taxing rights to market jurisdictions. There is strong ATAF support for allocation of more taxing rights to market jurisdictions as the rules reflect value created in those jurisdictions through marketing intangibles, sustained engagement and active participation of users. [60]

176. ATAF noted in the Third Technical Note that commodities should be excluded from the new profit allocation rules such as those relating to marketing intangibles, which are in its view often not a key value driver for commodities.

177. ATAF in the same note supports simplification measures for addressing artificial profit shifting, with a view to improving tax certainty, and reducing cost and time in resolving transfer pricing disputes. The approach should result in as close as possible an approximation to the arm's length profits, however[61].

178. ATAF also supports, in the Third Technical Note, the proposal in the distribution-based approach that the new profit allocation rule provides a baseline amount of profits attributable to marketing, distribution and user-related activities. The baseline amount should be a fixed minimum profit rather than a safe harbour that has an arm's length carve-out, which would pose difficulties in implementation to tax administrations with limited capacity. This position was affirmed by the ATAF Cross-border Taxation Technical Committee[62] (CBT), which opposes the use of mandatory safe harbours with an arm's length let out[63].Where there are more functions in the market jurisdiction than are compensated in the baseline activity the baseline profit should be increased based on those additional functions.

Mandatory Dispute Resolution Mechanism

179. The Third Technical Note recognizes a need to develop effective tax dispute resolution mechanisms however it ***opposes mandatory binding arbitration***.

---

58 Julie Martin, "Saint-Amans provides update on digital tax reform effort", *MNE Tax*, September 12, 2019

59 ATAF, "*The Tax Challenges arising in Africa from the digitalisation of the economy*", ATAF Technical Note number CBT/TN/01/19 available at:
https://events.ataftax.org/includes/preview.php?file_id=25&language=en_US

60 ATAF, "*Inclusive Framework proposals to address the tax challenges from the digitalisation of the economy*" Third Technical Note number available at:
https://events.ataftax.org/includes/preview.php?file_id=40&language=en_US

61 Ibid ATAF, p.6

62 The Cross-Border Taxation Technical Committee (CBT) is an ATAF representation in the Inclusive Framework Working Parties.

63 Ibid ATAF, p.6.

Issues Relating to Pillar Two: Global Anti-base Erosion

180. ATAF's Third Technical Note has indicated that work on Pillar Two of the POW will need to consider carefully whether the adjustment would be limited to the minimum effective tax rate and the impact of such a limitation on taxpayer behaviour on profit shifting out of jurisdictions with effective tax rates that might be significantly higher than the minimum effective rate.

181. The ATAF CBT has raised concerns about the ordering of the global anti-base erosion rules where the income inclusion rule might be implemented first yet most of the base eroding payments would arise from source jurisdictions. It was felt that a more appropriate approach would be to implement the Subject to Tax rule first as it would not be restricted to related party payments and will be straightforward to implement through the already effective withholding tax mechanism. This rule, it was felt, would help to address the current imbalance in allocating taxing rights between residence and source jurisdictions. The imbalance of residence and source jurisdiction allocation of taxing rights would also be addressed in the process.[64]

182. It was noted that Pillar Two's minimum effective tax rate may lead to another jurisdiction taxing the benefit of the tax incentive and therefore the CBT has taken upon itself to discuss with respective African countries the possible use and exclusions of tax incentive regimes.

183. Other concerns raised in the first Technical Note from ATAF are that:

- BEPS outcomes do not significantly reduce IFFs from Africa as they are largely specific and narrow. They lack strong anti-avoidance rules addressing profits shifted to low or no tax jurisdictions. In this regard focus should be on base eroding payment; and
- The new rule requires comprehensive exchange of information mechanisms,

Unilateral Measures

184. ATAF has taken a view in the Zimbabwe Outcomes Statement that "is more prudent to work together on a continental solution than implementing unilateral solutions as some countries have done worldwide". It has not given any specific guidance on the use of unilateral measures on digitalization of the economy.

185. A number of what could be described as unilateral measures have emerged in the region, for example: excise duties on digital transactions, fees for certain foreign service provision, VAT on digital service providers, or "equalization levies" on profits made by foreign digital businesses.[65]

186. One commentator on the ATAF developments has expressed the view that it would be important for Africa to implement their home-grown measures as an additional package to the Inclusive Framework developments. The international agreements currently being sought

[64] Ibid ATAF, p.6.
[65] See, e.g.: Mohammed Yusuf "Digital Taxation Troubles Tech Businesses in African Countries", Voice of America (1 September 2019) https://www.voanews.com/africa/digital-taxation-troubles-tech-businesses-african-countries

might make such adaptive approaches impossible, however[66]. The same author observed that there will be some gains for African countries in proposed changes, however it was unclear if the gains would outweigh the costs of the obligations that they impose.[67]

187. ATAF's VAT technical committee has noted that most African tax administrations are faced by low levels of automation and system integration due to technological challenges. This makes it difficult to view digital transactions. ATAF therefore recommended the use of the OECD's *Simplified Supplier Registration Regimes (SSRR)* to the member states and is further planning on capacity building on the regimes across Africa.

Cost of Compliance and Ease of Administration

188. ATAF noted in its Third Technical Note that there is a need for the rules to ensure that the burden of proof is on the taxpayer to demonstrate compliance and to provide relevant information to the relevant tax administration for effective implementation of the rules.

189. ATAF members are of the opinion that there should be rule co-ordination on the Program of Work to ensure that the new rules address; double taxation, compliance and administration costs and balanced allocation of taxing rights between source and residence countries.[68]

190. ATAF noted that while it is necessary to ensure that the rules provide certainty to the tax payer, they should be simple enough for the tax administrations to implement[69].

Political Support

191. The ATAF High Level Dialogue held in Zimbabwe in Aug 2019 confirmed the need to use political assistance through African Union and the Pan-African Parliament to ensure that African countries find a solution to taxing digital economy.

192. ATAF encourages, as noted in the Outcome Statement of the Zimbabwe High Level Dialogue, political support from the continent and active participation from African countries, which are part of the Inclusive Framework in the Working Parties as well as participation and engagement at the UN Tax Committee.

(d) EUROPEAN UNION;

Introduction

193. On 21 March 2018, the European Commission (EC) proposed the introduction of a digital services tax (DST) on revenues resulting from the provision of certain digital activities, as well as the introduction of a new regime relating to the corporate taxation of companies "with a significant digital

[66] Martin Hearson, "Africa Responds to the Inclusive Framework's Digital Tax Agenda", *International Centre for Tax Development 7th August 2019*
[67] Ibid Hearson.
[68] ATAF, Third Technical Note.
[69] ATAF, First Technical Note.

presence", aimed at addressing the tax challenges of the digital sector in the European Union. This part of the note examines the background, nature, and outcome of these proposals.

The Early EU Work

194. In 2013, the European Commission constituted a "High Level Expert Group on Taxation of the Digital Economy" to examine the best ways of taxing the digital economy in the EU, weighing up both the benefits and risks of various approaches. Its focus was on identifying the key problems with digital taxation from an EU perspective and presenting a range of possible solutions. The group reported back to the Commission on 28 May 2014.[70] The European Parliament released another report surveying the situation in 2016.[71]

195. On 21 September 2017, the European Commission released a Communication to the European Parliament and the European Council entitled "A Fair and Efficient Tax System in the European Union for the Digital Single Market"[72]. It called for a "a strong and ambitious EU position on taxing the digital economy, which should feed into ongoing international work on the issue."

196. The Communication noted the need to update nexus (permanent establishment) and allocation (including transfer pricing) rules, as part of a longer-term solution, in cases where presence is only virtual, and value is created through intangible assets, data and knowledge.

197. However, it also considered it necessary to consider some shorter-term alternatives such as:

- Equalization taxes on turnover of digitalized companies - a tax on all untaxed or insufficiently taxed income generated from all internet-based business activities, including business-to-business and business-to-consumer, creditable against the corporate income tax or as a separate tax;
- Withholding taxes on digital transactions - A standalone gross-basis final withholding tax on certain payments made to non-resident providers of goods and services ordered online; and
- Levies on revenues generated from the provision of digital services or advertising activity - A separate levy could be applied to all transactions concluded remotely with in-country customers where a non-resident entity has a significant economic presence.

198. The Communication recognized that all short-term options have pros and cons, including questions about the compatibility of such approaches with double-taxation treaties, state aid rules, fundamental freedoms, and international commitments under free trade agreements and WTO rules.

199. In October 2017, EU leaders in the EU Council meeting, called for "**an effective and fair taxation system fit for the digital era".** They stressed in their conclusions that "it is important to ensure that all companies pay their fair share of taxes and to ensure a global level-playing field in line with the work currently underway at the OECD".[73] In December of

[70] The Report is available at: https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/gen_info/good_governance_matters/digital/report_digital_economy.pdf

[71] http://www.europarl.europa.eu/thinktank/en/document.html?reference=IPOL_STU(2016)579002

[72] https://ec.europa.eu/taxation_customs/sites/taxation/files/communication_taxation_digital_single_market_en.pdf

[73] https://www.consilium.europa.eu/media/31263/19-euco-final-conclusions-en.pdf

the same year, the European Council adopted conclusions on **"Responding to the challenges of taxation of profits of the digital economy"**.[74] In those, they underlined the need to ensure that international tax rules are suitable for both the digital and more traditional sectors of the economy.

2018 Proposals

200. The March 2018 European Commission (EC) proposals had been broadly signalled by the September 2017 Communication and responded to the view, evident there, that current tax rules were not recognizing the new ways in which profits are created in the digital world, especially business models relying on users' data in generating value for digital companies. Consequently, there was a perceived mismatch between where value is created and where taxes are paid.

201. The package of proposals[75] involved four main elements:

1) A Communication to the European Parliament and the Council of the EU;
2) A proposal for a Council Directive laying down rules for the corporate taxation of a significant digital presence. This proposed a reform to corporate tax rules (the long-term solution) so that profits are taxed where businesses have significant interaction with users through digital channels, even if a company does not have a physical presence in the jurisdiction in question;
3) An accompanying Recommendation to the proposed Directive relating to the corporate taxation of a significant digital presence, and
4) A proposal for a Council Directive on the common system of a digital services tax (DST) on revenues resulting from the provision of certain digital services. This DST was proposed to be the interim solution, pending agreement on the longer-term solution. The tax would apply to revenues created from activities where users play a major role in value creation and which are the hardest to capture with current tax rules. The DST was to be charged at a rate of 3% on gross revenue from digital services.

202. The key aspects of the proposals in the two Directives can be summarized as follows:

Longer Term Nexus Issues

1) The long-term solution to taxing digital businesses provides a framework establishing a taxable significant digital presence by providing a uniform definition of a "Digital Permanent Establishment" in the corporate tax bases across the EU.
2) Significant digital presence is defined as a company having satisfied at least one of the following criteria in a member state:

   a) €7 million ($8.1 million) in annual revenues in a tax period resulting from the supply of the digital services to users located in that Member State;

   b) More than 100,000 users in the tax period;

   c) More than 3,000 contracts for digital services are concluded in that tax period by users in the EU Member State.

[74] https://www.consilium.europa.eu/media/31933/st15175en17.pdf
[75] European Commission, "Fair Taxation of the Digital Economy, https://ec.europa.eu/taxation_customs/business/company-tax/fair-taxation-digital-economy_en.

Longer Term Allocation Issues

1) The proposal would also establish methodology for allocating profits among countries in which a company has significant digital presence.
2) The EC envisioned that the proposal for defining significant digital presence and allocating profits for taxation accordingly would eventually be adopted into another one of its objectives of establishing a unified corporate tax base across Europe.

Short-term Solution (the DST)

Nexus Aspects

1) In contrast to the first (longer term) proposal, the short-term solution, the Digital Services Tax (DST), would apply to companies with both:
   a) Total annual worldwide revenues of €750 million ($868 million); and
   b) Total annual taxable EU digital revenues of €50 million ($58 million)
2) The DST would be a turnover tax levied by individual countries at a rate of 3 percent on gross revenues (less VAT and similar taxes) derived in the EU from:
   a) the placing on a digital interface of advertising targeted at users of that interface;
   b) the making available to users of a multi-sided digital interface which allows users to find other users and to interact with them, and which may also facilitate the provision of underlying supplies of goods or services directly between users; and
   c) the transmission of data collected about users and generated from users' activities on digital interfaces
3) These revenue sources are the ones that the DST focusses on because they were identified by the Commission as "revenues created from activities where users play a major role in value creation."[76]
4) The draft Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services This second proposed Directive represents a targeted (short-term) solution. It introduces a Digital Services Tax (DST) at EU level at a rate of 3% on gross revenue (net of VAT and other similar taxes) derived in the EU by the following activities (save for certain exceptions): The EC calculated that if the 3 percent DST were adopted, it would generate €5 billion ($5.8 billion) per year in revenues for EU member states. This would represent a revenue increase of approximately 0.08 percent relative to total revenue collected by the 28 EU member states in 2016.[77]

Allocation Issues

1) The proposed Directive sets out the principles for attributing profits to that significant digital presence. A functional analysis should be completed. The economically significant activities performed by the significant digital presence through a digital platform, would include, inter alia, the following:

   a) the collection, storage, processing, analysis, deployment and sale of user-level data;

   b) the collection, storage, processing and display of user-generated content;

[76] European Commission, "Fair Taxation of the Digital Economy".
[77] General government revenues across the European Union were nearly €6 trillion ($6.9 trillion) in 2016. http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_10a_taxag&lang=en (per Bunn)

c) the sale of online advertising space;

d) the making available of third-party created content on a digital marketplace; and

e) the supply of any digital service not listed in points (a) to (d).

2) In determining the attributable profits, the profit split method would be the default unless the taxpayer could demonstrate that there is an alternative method (based on internationally accepted principles) which is more appropriate having regard to the results of the functional analysis.

Nature of the Directive

203. The proposed Directive would apply to all taxpayers that are subject to corporate tax in one or more Member States and to entities resident for tax purposes in a non-EU jurisdiction, in respect of their significant digital presence in a Member State. To prevent action contrary to double tax conventions (DTCs) the Directive would not apply if an entity is resident for tax purposes in a non-EU jurisdiction that has in force with the Member State a DTC, unless that DTC includes similar provisions on a significant digital presence and the attribution of profits. to those of the draft Directive

204. The EC's accompanying Recommendation outlined how Member States should amend their DTCs with non-EU jurisdictions to reflect a significant digital presence, and attribution of profits thereto as per the above Directive.

205. The proposed Directive set out rules about the place of taxation of the DST based on the location of the users of the taxable service. The proposed Directive also proposes the establishment of a One-Stop-Shop for taxable persons with DST liability in one or more Member States.

The Response to the Proposals

206. The EC proposed that the "short-term" Directive should start to apply on 1 January 2020. As usual, however, the proposals had to be sent to the Council and the European Parliament for approval. The Directives would have to be formally adopted by the Council by unanimous vote, before they could come into force.

207. In fact, the required unanimity was never achieved, and the package has currently been put on hold. Some EU countries such as France are, however, moving forward with similar individual efforts. On 15 January 2019, the European Commission also presented a communication on how to move gradually from unanimity voting on tax matters to the usual EU legislative procedure of qualified majorities.[78]

208. There was a clear division of opinion on the package. While garnering considerable support, there was also strong opposition. The most frequent criticism of such a DST was that the true burden (or economic incidence) of the tax would fall on users and companies that purchase online advertisements and place their products on online marketplaces. Just as the costs of sales taxes are passed on to consumers, the cost of this tax would likely be passed

[78] See: https://ec.europa.eu/taxation_customs/sites/taxation/files/15_01_2019_communication_towards_a_more_efficient_democratic_decision_making_eu_tax_policy_en.pdf

on to a multitude of companies that are trying to sell their products over the internet to a broad set of consumers.[79]

209. The EC's proposal faced steep opposition from certain jurisdictions including Ireland, Finland, Denmark and Sweden[80] including on the basis that it was better to work through OECD processes than to provide a separate EU "track" and that it might stifle entrepreneurship to give more emphasis to markets and less to the location of, for example, intellectual property. The Ministers of Finance of the latter three countries issued a joint statement on 1 June 2018[81] noting that:

> In March 2018 the EU Commission made two proposals for directives introducing special tax rules for the digital economy. We welcome and support the active EU engagement in the discussion on counteracting base erosion and profit shifting in light of digitalization but note that the two proposals are mainly about changing the current rules for allocating taxable income between countries, for the digital economy, rather than fighting tax avoidance. The proposals partly shift taxing rights to the country of the consumer or the digital user, based on the premise that these contribute to value creation in the digital economy.
>
> This deviates from internationally established principles. Traditionally, exporting firms do not pay taxes in their export destination simply because they have consumers there. The proposal for a digital services tax means that basically all value creation is deemed to take place at the location of the consumer. Furthermore, a digital services tax deviates from fundamental principles of income taxation by applying the tax on gross income, i.e. without regard to whether the taxpayer is making a profit or not.
>
> Such substantial changes to the current international principles need to be discussed and agreed internationally. …
>
> We believe there are no reasons to deviate from internationally established principles regarding the allocation of taxing rights for the digital economy. The digital economy as well as the traditional economy should be taxed where value is created. Therefore, there should be a thorough analysis whether and to what extent, users in some specific digital business models contribute by creating value for the business and whether this should be somehow reflected in taxation.
>
> This analysis needs to reach a certain international consensus to be effective, and so a substantial part of it must again be done in the OECD. The Nordic countries will continue to participate actively and constructively in such work, and we would support an acceleration of the OECD discussions on this topic, so that we can find a consensus-based solution rapidly. In these discussions, we must also keep in mind the crucial part innovation and research and development play in creating value for businesses and growth and welfare in general. A system based on where the users are located must not reduce the incentives for states to provide a favourable climate for business.

[79] See e.g. Bunn and (cited therein): Matthias Bauer, "Five Questions about the Digital Services Tax to Pierre Moscovici," ECIPE Occasional Paper, April 2018, http://ecipe.org//app/uploads/2018/06/Five-Questions-about-the-Digital-Services-Tax-to-Pierre-Moscovici.pdf.

[80] See e.g.: Reuters, "Nordic countries oppose EU plans for digital tax on firms' turnover", 31 May 2018, https://www.reuters.com/article/us-eu-digital-tax/nordic-countries-oppose-eu-plans-for-digital-tax-on-firms-turnover-idUSKCN1IW337 , Julie Martin, "EU finance ministers drop proposal for digital tax", *MNE Tax,* March 12, 2019, https://mnetax.com/finance-ministers-drop-proposal-for-eu-wide-digital-tax-32873

[81] Available at: https://www.government.se/statements/2018/06/global-cooperation-is-key-to-address-tax-challenges-from-digitalization/

….

The Current Situation

210. Efforts were unsuccessfully made to work on compromise texts exploring whether a DST of narrower scope could be accepted by delegations. That attempt failed, and a year after the proposal was first announced EU finance ministers formally abandoned the proposal. The EU then confirmed that it would focus on the broader international tax discussions underway at the OECD and G20 level, and that if progress was not made by the end of 2020 on global efforts, the EC would revisit the issue.[82] As the EU's record of the outcomes of the 12 March 2019 Economic and Financial Affairs Committee (ECOFIN) meeting indicates:[83]

> The Council took note of the progress achieved in the negotiations on the digital services tax, since the issue was last discussed at the ECOFIN meeting of 4 December 2018, on the basis of a new compromise text setting out a scope limited to digital advertising services.
>
> The discussion revealed that despite the broad support from a large number of member states on this text, some delegations maintain reservations either on some specific aspects of the proposal or more fundamental objections.
>
> In parallel, the Presidency will conduct work on the EU position in international discussions on digital tax, in particular in view of OECD's report on the issue, due by mid-2020.

211. The Package has not, it appears, been formally withdrawn by the Commission, however, apparently based on the view that "it will provide guidance for member states that want to move forward at the national level but will also be on the table if no agreement is reached at the international level this year".[84]

212. The European Commission has been awaiting its new leadership team but in a September 10 2019 "Mission Letter", European Commission President-elect Ursula von der Leyen proposed that Margrethe Vestager, who has served as EU competition commissioner for five years, should coordinate "work on digital taxation to find a consensus at [the] international level by the end of 2020 or to propose a fair European tax."[85]

213. The new role gives Vestager wide responsibility for formulating the EU's digital policies during her five-year term that will begin November 1 after confirmation hearings have been held by the European Parliament.[86]

[82] https://data.consilium.europa.eu/doc/document/ST-6873-2019-INIT/en/pdf
[83] https://www.consilium.europa.eu/en/meetings/ecofin/2019/03/12/
[84] Statement attributed to EU Tax Commissioner Pierre Moscovici, Elodie Lamer, "EU Fears Divisions over Digital Tax will Weaken its Voice", *Tax Notes International*, 13 March 2019.
[85] Teri Sprackland, "Vestager Gets More Power to Regulate Digital Economy" (Sprackland) *Tax Notes International,* 11 September 2019.
[86] Sprackland.