FACULDADE DE DIREITO
Universidade de Lisboa

INTERNATIONAL TAX REFORM TO ADDRESS THE DIGITAL ECONOMY: HOW TO EFFECTIVELY TAX PROFITS FROM HIGHLY DIGITALISED BUSINESSES IN THE MARKET JURISDICTIONS?

David Rodrigues Custódio

Master's Thesis

Under the supervision of Professor Ana Paula Dourado

Research-focused Master's Programme

Tax Law

2021

Acknowledgment

A special mention must be made to the honourable Professor Ana Paula Dourado, for not only her guidance, counsel and support, without which this thesis wouldn't be written, but more importantly for sparking my deep interest in international tax law during her classes. It was a pleasure to be her student and it truly shaped my professional career and academic endeavours. For this, I will forever be grateful.

To my friend and tax colleagues, who contributed with critical opinions of this study.

To my mother, father and sister for the unconditional support and care.

To my girlfriend, for the motivation she gives me to become a better version of myself.

To the Faculty of Law of the University of Lisbon, for the knowledge and life lessons it taught me.

ABSTRACT

The scope of this study, within the main theme of international taxation of corporate profits, deals specifically with the alternative theoretical model – the digital permanent establishment – taking into account the recent changes in the economy and new business models.

The international tax rules in force, as well as the respective interpretative elements, are unable to tax in a fair and equitable way the profits generated by multinational companies operating in the digital economy. A paradigm shift in this regard is imperative, preferably carried out in a harmonised manner between countries.

Of the various theoretical models studied and evaluated to address this problem, the most appropriate one, in our opinion, is the creation of a digital permanent establishment, characterised by modern and comprehensive criteria that enable the inclusion of the digital economy, for this purpose providing objective linking criteria in the jurisdictions where a company operates.

Keywords: International Taxation, Digital Economy, Permanent Establishment, Tax Fairness, Corporate Profit's Tax

RESUMO

O escopo deste estudo, dentro do tema geral da tributação internacional dos lucros de empresas, trata em concreto um modelo teórico alternativo – o estabelecimento estável digital – tendo em especial consideração as recentes transformações na economia e os novos modelos de negócio.

As normas internacionais fiscais em vigor, assim como os respetivos elementos interpretativos, não estão hoje aptas para tributar de uma forma justa e equitativa os lucros gerados por empresas multinacionais com operações na economia digital. É perentória uma alteração de paradigma a este respeito, preferencialmente feita de uma forma concertada entre países.

Dos vários modelos teóricos estudados e avaliados para colmatar este problema, o que se afigura mais apropriado na nossa opinião é a criação de um estabelecimento estável digital, caracterizado por critérios modernos e abrangentes que permitam incluir as realidades da economia digital, para tal prevendo critérios objetivos de conexão nas jurisdições onde uma empresa opere.

Palavras-Chave: Tributação Internacional, Economia Digital, Estabelecimento Estável, Justiça Tributária, Imposto sobre os Lucros de Empresas

ABBREVIATIONS

ADS	Automated Digital Services
AI	Artificial Intelligence
ALP	Arm's Length Principle
AOA	Authorised OECD-approach
BEPS	Base Erosion and Profit Shifting
CDT	Convention to Avoid the Double Taxation
CFB	Consumer Facing Business
CIT	Corporate Income Tax
DST	Digital Services Tax
EC	European Councill
EU	European Union
GAAP	Generally Accepted Accounting Principles
IMF	International Monetary Fund
OECD	Organisation for Economic Co-operation and Development
OECDMT	OECD Model Tax Convention on Income and on Capital
PBT	Profit Before Tax
PIT	Personal Income Tax
PE	Permanent Establishment
TFEU	Treaty on the Functioning of the European Union
TT	Tax Treaty
UBO	Ultimate Beneficial Owner
UK	United Kingdom
UN	United Nations
UNMDTC	United Nations Model Double Taxation Convention
UPE	Ultimate Parent Entity
USA	United States of America
VAT	Value Added Tax

Table of Contents

I. CHAPTER ONE: INTRODUCTION – DIGITAL ECONOMY & TAX 1

1. Political Context Regarding the Digital Economy 7

II. CHAPTER TWO: THE CONTEMPORARY MODELS TO ASCERTAIN TAXING RIGHTS IN A DIGITAL ECONOMY 12

1. Re-Evaluation of the Existing Tax Rules and the PE Concept: Is Physical Presence Enough? 12

2. Creation of a Multilateral-based New Taxing Right: The OECD/G20 Report on Pillar One Blueprint 16

2.1. General remarks 16

2.2. Activity test and Threshold test 19

2.3. Tax Base Determination 23

2.4. Profit Allocation Rules 24

2.5. Avoiding Double Taxation 26

2.6. Amount B 27

3. Adapting the Existing International Tax System: A Withholding Tax on Digital Services 29

3.1. General remarks 29

3.2. The Proposal of the UN to Add Article 12B to the Model Tax Convention 30

4. Redefinition of the Permanent Establishment: The Digital PE 36

4.1. General remarks 36

4.2. The '*Significant Digital Presence'* Test 37

4.3. The EU Commission's Directive Proposal 40

III. CHAPTER THREE: A CRITICAL AND CONSTRUCTIVE VIEW OF THE PROPOSED MODELS 44

1. Critical Deficiencies and Challenges of the New Taxing Right (Pillar One) 44

1.1. General remarks 44

1.2. Pressure for Widespread Consensus 45

1.3. Ring-Fencing the Digital Enterprises 48

1.4. Overly Complex 50

1.5. Burden for Tax Administrations 58

1.6. Taxation on Gross Income 60

1.7. 'Double Counting' Issue 63

1.8. Conclusion 65

2. Necessary Improvements to a Treaty Withholding Tax for ADS 67

2.1. General remarks 67

2.2. Gross Basis vs. Net Taxation 67

2.3. Amount of Qualified Profits 68

2.4. Conclusion 69

3. Challenges of the Digital PE and Significant Digital Presence Test 71

3.1. General Remarks 71

3.2. Substantial Requirements 71

3.3. Profit Allocation via Extraterritorial Tax Enforcement 73

3.4. Conclusion 74

4. The Role of User-Based Value Creation 76

IV. CHAPTER FOUR: CONCLUDING REMARKS 86

V. BIBLIOGRAPHY 95

I. CHAPTER ONE: INTRODUCTION – DIGITAL ECONOMY & TAX

The economy is a constantly evolving science. New solutions, in the form of goods, products and services, are consistently invented in order to fix people's daily lives' problems and obstacles. Corporations and businessmen strive to be updated with modern technology and have become increasingly sophisticated. In the last two decades, since the rise and prosperity of the world wide web, the behaviour and habits of consumers have substantially changed due to new online products and services, with the economic agents repeatedly providing more updated solutions, in the digital field, to users and consumers.

With the assistance of globalisation and advanced technology development, ground-breaking and innovative digital services provided to consumers, such as a computer software, an application on a smartphone or an online social media platform, are capable of now reaching a worldwide scale in a matter of moments, seemingly effortlessly and bearing much lower costs than a conventional business would have to carry to deliver a physical product or service.

This modern digitalization of the economy has led, in a broad sense, to a great improvement in society's general welfare and evolvement, as well as creating new habits for users and consumers, regardless of the generations at stake. Indeed high-tech goods and its inherent services have greatly changed everyone's lives.

Furthermore, considering the economy in particular, this general progress has modified the way businesses and corporations are created, operated, managed, and ultimately how and where they generate profits. In the beginning of this century several businesses were founded, with unconventional governance models and new technology, that completely broke the status quo and, truthfully, the international and national tax systems have not yet been adapted to this day. Both the legislative powers and political agents have not until recently paid the needed attention to this economic revolution's tax impact, in order to implement fair rules of profit's taxation derived from these companies internationally.

And this is key argument – i.e., the mismatch between the current tax rules and the new and evolving digital business models – is the fundamental problem at stake here and the starting point of this thesis. Why aren't the national and international tax rules applicable to the digital economy? What is its impact to domestic economies?

What started as an 'out-of-date' legal framework, in what tax rules are concerned, has grown into a spectrum where multinational corporations in the economy's digital sector, particularly those with a strong global presence, have been taking advantage of legal loopholes to significantly avoid taxes on their profits on countries they are present and deriving profits from, when compared to other sectors.

And this matter is important, because there is a fundamental principle of fairness, equality, and justice at stake, in the form of tax collection by sovereign States.

Such principles dictate that the scope of the tax rules on corporate profits should rightfully include digital companies and create an equal playing field between these economic agents – therefore the corporation's presence in a domestic economy of a particular country should have impact on the profits paid therein.

Hence, addressing this problematic topic and finding a balanced solution will ensure that an equilibrium between taxpayers and its liability to tax, guaranteeing that those who generate more profits are taxed accordingly.

In this thesis we will analyse and dissect the different proposals being considered at the moment to contribute to the evolution of the tax system to integrate digitalised businesses.

To understand the genesis of this problem we will need a brief historical context and perspective.

Well, since the beginning of the 19th century, companies with cross-border activities and turnovers have relied on legal agreements in force, concluded between sovereign states, with the intent of minimising their exposure to double taxation of corporate profits[1]. The potential international tax planning efforts were made from this network of tax treaties.

These agreements as we know them today, along with its interpretation elements, are the product of decade's work to provide taxpayers with a ruleset that ensures a fair share

[1] See **SUNITA JOGARAJAN**, *The Conclusion and Termination of the 'First' Double Taxation Treaty*, British Tax Review, Vol. 3, 2012, U. of Melbourne Legal Studies Research Paper No. 604. Later in 1960's with the publishing of the Model Tax Convention these tax agreements proliferated, see **OECD,** *Model Tax Convention on Income and on Capital: Condensed Version 2014*, OECD Publishing, Paris, page 9.

of taxing rights to each Contracting State, considering many different scenarios, depending on where a single person or company is located (and the subsequent quality of resident or non-resident) and establishing the tax rules (as well as tax limitations rules) according to where the economic value was created (the "origin of wealth")[2]. From a theoretical point of view, a State would have the right to tax both residents and non-residents on the grounds of the benefit theory, because, according to this principle, a State's tax right originated on the fact that it provided basic resources and workforce to allow the foreign company to have a meaningful interaction with local economy and therefore generate its profits[3]. The OECD and the UN models developed this theory into the concept of a permanent establishment – a fixed and physical place were a business or a person acting on behalf of a non-resident enterprise would be present in a State which would allow a source taxation, at least partially and limitedly, of the income effectively connected with such permanent establishment.

Following the aforementioned globalisation of the economy and the rising of highly digitalised business models, unfortunately (but expectedly) the international taxing rights in force by these agreements – the CDTs – have progressively become more obsolete in what regards the cross-border income derived from digital services provided by non-residents companies. Essentially, because the digital economy has progressed in such a way that enterprises may generate cross-border income (with a significant influence on the local economy) without establishing a physical presence in a given country – and the rules established on tax treaties are not so abstract as to foresee this situation.

Besides, the technologic and information communications translate into intangible assets (software), protected by IP rights, further allowing aggressive tax planning (through the intermediation of associated companies headquartered at low or no tax jurisdictions) that leads to tax base erosion[4].

Once identified this problematic, the primary aim of this thesis is to study the existing proposals for tax reforms that tackle this issue, its pros and cons, as well as, more

---

[2] See **OECD**, *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p. 24 to 28.

[3] See **PINTO, D.**, "*The Need to Reconceptualise the Permanent Establishment Threshold*", Bulletin for International Taxation, 2006, IBFD pp. 266-279, **VOGEL, K.**, *"Worldwide vs. source taxation of income – A review and re-evaluation of arguments (Part 3)", Intertax*, 1988, Vol. 11, pp. 393-402.

[4] See **OECD**, *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, …, p. 81.

importantly, to give opinion over which model we believe to be the most appropriate and effective in order to ensure a fair a balanced framework for the overall corporate taxpayers.

Henceforth, this thesis will attempt to demonstrate that the appropriate tax model to fairly levy profits of highly digitalised companies (proving digital services to online users) is the creation of a new tax nexus, on the Source State, founded on a significant digital presence – the 'digital permanent establishment' or 'Digital PE'–, which is inherently independent of pure physical requirements as to ascertain a right of this State to tax.

Nevertheless, in this regard, between the academic literature many studies, with different approaches, have addressed this issue in an attempt to find a more efficient and reliable method of ensuring a fair taxation within the digital economy.

On the other hand, policy makers also started to put forth proposals to this regard, gathering political consensus and working on soft law instruments in order to obtain governmental commitment from countries.

The Chapter II of this thesis will highlight and analyse the main public proposals at the moment with the focus and scope of adapting the international taxing system. According to our research they are the following:

(i) A new and co-existent taxing right over residual profits earned by Multinational Enterprises (MNEs) that provide digital services;
(ii) A treaty-based withholding tax on income derived from digital services provided by non-residents; and
(iii) The creation of a different nexus in the state of source, the Digital PE, by introducing a significant digital presence test.

After analysing and critically reviewing each model and their inherent elements, specifically on Chapter III, the author of this thesis will showcase the arguments to conclude what the most appropriate, fair and efficient method is to tax highly digitalised business models.

In general, the future set of rules to be included in the domestic and, ideally, international tax system should be broadened in its scope, to the point that it includes all

types of activities and taxpayers. In other words, in the author's opinion ring-fencing the digital economy shall be avoided in order to safeguard the principle of equality.

On the other hand, at the international level, in spite of the harmonised multilateral framework of hard law being the most desirable – as it significantly increases effectiveness of the measures – however it should not, in the authors opinion, jeopardise other proposal whose aspect prevails execution and administrability of such given rulesets by public services. As we will see, a desire for widespread political consensus might, in some cases, undermine a given proposal as a whole.

Lastly, the model which we will defend provides, in our opinion, a sustainable and long-lasting solution harmonised with the current rules. Perhaps the only disruption it may cause regards the coexistence with the arm's length principle, which we will have the opportunity to explain.

Once the valuation of the current contributions and a standpoint has been made clear by the author, the final chapter of this thesis will delve into the theme of economic value creation and its correlation with a fair and equal taxation of digital companies' profits.

The main argument, which we will further develop and explain, is that the elements and factors that attribute economic value to a product or service nowadays are not the same as they used to be one hundred years ago – hence, the modern interpretation of the principle of the benefit theory can be no other than to incorporate the users or consumers involvement into taxing rights, as it is a major factor to influence the value of any digital company.

In reality, the contribution of users in a given digital product or platform (e.g., social media or online marketplaces), in number and in the degree of participation (including content creators), significantly influences the real economic value of a digital services' enterprises, because most of these companies generate revenue by placing adverts, that naturally have a higher marketing cost the more users are using the company's services.

As we will further highlight, transposing this idea into specific legal rules is a very challenging task (reason why many authors oppose to it), and not so much as to establish scoping rules that include user-based value criteria (which is achievable), but regarding the taxable profits allocation rules, because how may one measure the influence of the user involvement in a domestic economy and the specific correlation with the global

profits generated by the company? A rather difficult task for any legislator indeed. In our opinion, as we will justify, a departure from the traditional FAR analysis under the Authorised OECD Approach could be the starting point.

By the end of this thesis we hope the reader is able to identify the problem as stake and the importance of achieving a general solution: highly digitalised models have not been subject to an equal tax on profits as other companies have for much too long, due to the inability of updating the international tax system to contemplate these new forms of business. This has and is causing effects on local economies as States do not receive a fair part of taxes for the digital services operated in their country, simply because there is no physical permanent establishment to establish a nexus that would allow source taxation.

On the other hand, the thesis aims at presenting to the reader, out of all the positions at play, the most adequate and sustainable option, in the authors opinion, to rightfully start solving this problem, thus contributing to the restoration of tax equality, by means of redefining the concept of the perhaps outdated permanent establishment, henceforth evolving into a modern and more technological model: the digital permanent establishment, or digital PE.

1. Political Context Regarding the Digital Economy

Through the last decade, recent disputes related with alleged tax avoidance between multinational enterprises (MNE) operating in the digital economy sector, such as between Amazon and the European Commission, have rather placed the spotlight under the issue of tax exposure from digital companies operating globally on the digital economy with sophisticated corporate structures[5].

Perhaps the first real political concern was put forth by the OECD and the G20 group, thus being drafted and published the BEPS reports, contemplating 7 Actions – a comprehensive legal analysis of various problems arising in light of our current international tax system. The Action that is particularly relevant in this topic and which deserves highlighting is Action 1: *"Addressing the Tax Challenges of the Digital Economy"*[6].

This report provided insightful conclusions that are still valuable today. In the first place, the Action 1 report stated that "*digital economy is increasingly becoming the economy itself,"* therefore "*it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes*."[7]. We completely agree with such reasoning, reason why some of the proposals contemplated and criticised in this thesis tending towards a ring-fenced approach will be highlighted and rejected.

A second and quite crucial conclusion was that the new highly digital business models, tending towards monopolies regarding digital services or platforms, "*present some key features which are potentially relevant from a tax perspective*.", such as intangibles assets, users, reliance of data and network effects[8]. As this thesis will attempt to demonstrate, a fairer and more adequate framework to subject MNEs profits to tax must consider these key factors in its formula.

---

[5] See, amongst others, Judgment of the General Court of 12 May 2021 – Luxembourg and Amazon v European Commission, Cases T-816/17 and T-318/18, Judgment of the General Court of 15 July 2020 – Apple and Ireland vs European Commission, Cases T-778/16 and T-892/16.

[6] See OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. Available through the following link http://dx.doi.org/10.1787/9789264241046-en (accessed in November 2018).

[7] See OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1…* page 142.

[8] See OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1…* page 143.

Since 2015, date of the abovementioned reports' publishing, until the present day, many academics published important opinions and contributions about the topic, which will be further analysed, although there are yet to be taken legally binding political decisions (i.e., hard law approved), namely within the European Union or the OECD, to effectively and fairly subject these companies' profits to tax, regardless of the legal instrument applied. It is important to highlight that the path towards resolution of matters such as this one most desirably should have a coordinated plan, in order to be successful and effective, given the unanimity rule in the EU, for example.

Furthermore, on March 16th of 2018, the OECD published the Interim Report[9], which is essentially a follow-up to the BEPS Action 1 report. Moreover, this report presented the current inconsistencies of the outdated international tax system in dealing with such a phenomenon as the Digital Economy. It reiterated the need to adapt the current model, however a debate started regarding the relevance of value creation, as cited: "*While there is general agreement that data and user participation are common characteristics of digitalised businesses, there are differences of opinion on whether and the extent to which data and user participation represent a contribution to value creation by the enterprise*.[10].

This topic is still much debated today, and will be address in Chapter III, regarding what type of impact user participation and data collection should have on nexus and profit allocation rules of MNEs taxation. On the other hand, this interim report showcased the use of interim measures applied by jurisdictions in order to tackle the growing misalignment between tax rules and digital companies' operations, typically with sectoral turnover-based targeted at revenue from online advertising services, such as India, Italy, Hungary and France[11] – which has grown to this day, jeopardising the harmonised application of a new common tax framework regarding the digital economy.

Following this document was the first attempt to implement actual legal normative, and for that reason particularly important and well debated, the EU Commission's Council Directives proposals to ensure a "*Fair Taxation of the Digital Economy*"[12]. These

[9] OECD, *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. Available through the following link: http://dx.doi.org/10.1787/9789264293083-en (accessed in November 2018)
[10] OECD, *Tax Challenges Arising from Digitalisation – Interim Report 2018:…* page 25.
[11] OECD, *Tax Challenges Arising from Digitalisation – Interim Report 2018:…* page 140.
[12] Giving the social pressure from the tax avoidance and state aid cases of some tech MNEs, the EU Commission felt the need to put forward some regulation in this matter: *"Faced with rising inequalities*

proposals aimed specifically at the Digital Economy. The Commission suggests two actions: the first one, a temporary interim measure, materialised in an equalisation tax over the revenues of such companies performing digital services (following the abovementioned measures); and a second one, a long-term solution that aims to put in force a digital permanent establishment, thus reformulating the existing tax rules for this matter.

However, it may also be well pointed out, as some authors actually did in tax literature[13], that these two proposals were in reality a political "counterattack" towards the United States (US), as the scope of such Directives mostly affected American multinational companies operating in the digital economy over in the EU. Consequently, the US Senate's Committee on Finance addressed, on October 2018, the President of the European Council, Mr. Donald Tusk and President of the European Commission, Mr. Jean-Claude Juncker, by virtue of an open letter, formally expressing the disagreement with the foreseen equalisation tax, or as also mentioned, the digital services tax (DST)[14].

In this letter, the US Senate expressed its concerns and pointed out what are the most important and fundamental aspects of the interim proposal for an equalisation tax. Despite the fact that this is politically based statement, with underlying interests, European authors[15] that are against such interim measure have shown that there is scientific ground

---

and perceptions of a lack of social justice, EU citisens are calling for Member States and the Commission to take action to improve the fairness of tax system" in European Commission, *Communication From The Commission To The European Parliament And The Council*, Brussels, 21.3.2018 COM(2018), page 3. Available through the following link: https://ec.europa.eu/taxation_customs/sites/taxation/files/communication_fair_taxation_digital_economy_21032018_en.pdf (accessed in November 2018).

[13] See **YARIV BRAUNER**, *Editorial: Taxing the Digital Economy Post-BEPS, Seriously*. 46 Intertax, 2018, Issue 6/7, page 464: "*Take, for example, the apparent decision of the EU to promote an equalisation tax designed to target primarily United States MNE at a time when the political relationships between the United States and the EU are challenged. It gives one an impression of a political (retaliatory) rather than a technically sound move*".

[14] United States Senate, Committee on Finance, 2018. The letter is available at the following link: https://www.finance.senate.gov/imo/media/doc/2018-10 18%20OGH%20RW%20to%20-Juncker%20Tusk.pdf (accessed in November 2018)

[15] As we will further analyse. S. **GEORG KOFLER, JULIA SINNIG**, *'Equalisation Taxes and the EU's 'Digital Services Tax"*, (2019), 47, Intertax, Issue 2, page 200: "*Besides broader implementation issues (such as the impact on investment, innovation, and growth, as well as on social welfare, a shift of the economic incidence of the proposed DST to consumers, the risk of over-taxation, and administrative burdens of implementing and enforcing a new tax), equalisation levies raise a number of other issues. Concretely, as they are intentionally created to sit in between CIT systems and consumption taxes, they must still comply with existing international obligations, such as DTCs and EU and WTO law. (…) Further, the tax rate applicable*

to support the arguments brought up by what is the home State of some of the biggest high-tech companies in the world. And, in general terms, interim measure is indeed evitable and dangerous. In short, the US Senate, by means of this letter, finds that the actions of the EU Commission, in specific its Council Directive proposal for digital services tax, advocated for:

1. A ring-fenced tax regime targeting only American digital companies, which represents a discrimination and puts these companies in a competitive disadvantage, with no apparent objective reason;
2. An innovative tax departing from the long-lasting principle of net-based taxable profits, that will ultimately lead to corporate double taxation, in the sense that it will not be considered as a cost in the corporate income tax rules, nor the VAT, therefore generating a legal loophole, pursuant of international tax rules and treaties;
3. High administrative and compliance costs for EU Member-States and taxpayers – posing, for the latter, as a barrier for transatlantic trade and investment –, regarding a 'temporary' measure that will, supposedly, be disregarded later for a final solution[16].

As for the political background, what seems to deeply worry the United States, as it was repeatedly announced in the open letter, is that by approving such Council Directive the EU would be taking a 'unilateral' position, disregarding the '*international consensus'* being promoted by the OECD, through its Task Force on the Digital Economy (TFDE)[17].

Well, in this respect we have to highlight two points in order to reach a conclusion: first, the US is a member country of the OECD, therefore it is well aware that such equalisation tax is being articulated as a strong possibility to effectively tax Digital Economy[18]; on a second note, and most importantly, the OECD does not have any kind

to gross revenues as well as the creation of revenue thresholds intended to exclude SMEs to promote innovation and growth need to be determined carefully, taking into account the significant economic impact such levies may have. EU law prescribes equal treatment of domestic and cross-border situations."

[16] See United States Senate, Committee on Finance, 2018, link above on footnote 14.

[17] It is declared in the letter that *"the EU should refocus its efforts away from this interim tax measure and back on reaching consensus with other leading economies within the OECD on new digital taxation models"*.

[18] See from OECD, *Interim Report, op. cit.,* pages 19 and 134 to 137; and from **OECD**, *Action 1 - BEPS, op. cit.,* pages 13 and 115-117. Therefore, the EU is not contemplating a surprisingly new measure against the referred 'international consensus'.

of legislation powers itself, only is able to create soft law and put forth recommendations. Henceforth, should the EU Commission want to impose the OECD's recommendations, like the digital services tax, it would ultimately need to pass a Council Directive, like it was done in the past[19].

Thus, even though we also find that the equalisation tax, as it is being proposed, is not the most efficient and sustainable way to address the issue, the position assumed by the US in this open letter is, in our opinion, politically motivated and not technically and taxpayers oriented.

[19] For example, after the BEPS conclusions and public discussion, the EU passed the Council Directive 2016/1164, of 12 July 2016, laying down rules against tax avoidance practices that directly affect the functioning of the internal market. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2016.193.01.0001.01.ENG (accessed in November 2018).

II. CHAPTER TWO: THE CONTEMPORARY MODELS TO ASCERTAIN TAXING RIGHTS IN A DIGITAL ECONOMY

1. Re-Evaluation of the Existing Tax Rules and the PE Concept: Is Physical Presence Enough?

It is consensual amongst the literature and political institutions that according to the current international tax system a solution cannot be found to effectively and fairly levy the profits accrued by companies operating within the digital economy. The way companies operate, its business models and the respective services provided have shifted into the digital era. Moreover the rules previously established sought physical elements that no longer exist. Therefore, most of the literature and the political institutions have long been supportive of a thoughtful transformation of the existing tax rules in this regard[20].

[20] See for institutional positions: **EUROPEAN COMMISSION**, *Directorate-General of Taxation and Customs Union*, Platform for Tax Good Governance: Long-Term Solutions to Tax the Digital Economy, Brussels, 18/10/2017 Platform/31/2017/EN, available at https://ec.europa.eu/taxation_customs/sites/taxation/files/dig_tax_disc_pap_long_term_sol_en.pdf, **EUROPEAN COMMISSION**, *Communication From The Commission To The European Parliament And The Council*, Brussels, 21.3.2018 COM(2018), available at https://ec.europa.eu/taxation_customs/sites/taxation/files/communication_fair_taxation_digital_economy_21032018_en.pdf (accessed 08/06/2021), **OECD**, *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, **OECD**, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, 2020, OECD Publishing, Paris, **OECD** *Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors*, Saudi Arabia (OECD Publishing, Oct. 2020).
In terms of literature that was addressing this point at the time see **Y. BRAUNER & P. PISTONE**, *Adapting Current International Taxation to New Business Models: Two Proposals for the European Union*, 71 Bull. Intl. Taxn. 12 (2017), Journal Articles & Opinion Pieces IBFD, **JOSÉ ÁNGE & GÓMEZ REQUENA**, "*Adapting the Concept of Permanent Establishment to the Context of Digital Commerce: From Fixity to Significant Digital Economic Presence*", (2017), 45, Intertax, Issue 11, pp. 732-741, **YARIV BRAUNER**, 'Editorial: Taxing the Digital Economy Post-BEPS, Seriously' (2018) 46 Intertax, Issue 6/7, **ANA PAULA DOURADO**, *'Editorial: Is There a Light at the End of the Tunnel of the International Tax System?'*, (2018), 46, Intertax, Issue 8, pp. 607-609, **ADOLFO MARTÍN JIMÉNEZ**, *'BEPS, the Digital(ised) Economy and the Taxation of Services and Royalties*', (2018), 46, Intertax, Issue 8, pp. 620-638, **MAARTEN F. DE WILDE**, *Comparing Tax Policy Responses for the Digitalizing Economy: Fold or All-in*, (2018), 46, Intertax, Issue 6, pp. 466-475, **ERIC C.C.M. KEMMEREN**, *Should the Taxation of the Digital Economy Really Be Different?*, (2018), 27, EC Tax Review, Issue 2, pp. 72-73, **PAOLO CENTORE, MARIA TERESA SUTICH**, *Taxation and Digital Economy: Europe Is Ready*, (2014), 42, Intertax, Issue 12, pp. 784-787.

Given the fact that one of the foundations upon which the international taxing system is built is the physical presence, once this key requirement is unnecessary for a non-resident company to in fact generate profits and for corporate income not to be connected with such permanent establishment, this system crumbles apart. And the appropriated reaction to this legal loophole was and has not yet been the appropriate one, as pointed out by Prof. Yariv Brauner: "*The instinctive response to these challenges, a revision of the rules in adaptation to the new business environment by tweaking of their application based on the principles of which these rules have been derived, simply failed. These rules all relied on physical presence to legitimise and enforce taxation…*"[21]. Continuing this rationale, other authors likewise conclude that "*International tax law has unquestionably failed to keep pace with the wideranging expansion of the DE [digital economy] motivated by the advances in ICT [information and communication technology]. This has resulted in different concepts and institutions of international tax becoming outdated and surrendering before the digital phenomenon.*" [22].

The lack of action from political institutions towards renovating the legal framework in order to address the digital economy has led to unfair and unequal situations where tax administrations simply do not have the tools to levy taxes on income derived from digital activities in their respective countries. The national and international tax systems are not yet adapted to the new and complex business models operating in the DE. In the efforts to present viable solutions, the OECD, for example, have highlighted that countries' need to re-consider the rules to determine the relevant nexus with a jurisdiction for tax purposes, however not giving up the fundamental and guiding principles of the current tax system[23].

Taking into account that a long-term solution (consisting of a reform of the current international tax system) requires time and will not be reached in the near future, sovereign States have taken unilateral measures to tax the digital sector in order to level the playing field.

---

[21] **YARIV BRAUNER**, 'Editorial: Taxing the Digital Economy Post-BEPS, Seriously' (2018) 46 Intertax, Issue 6/7, p. 463.
[22] See, **JOSÉ ÁNGE & GÓMEZ REQUENA,** *ibidem,* p. 733
[23] OECD, *Interim Report*, *op. Cit.* paragraphs 381, 390 and 391.

More recently, taking into account the literature's contributions, a number of proposals from policy makers (such as the EU, UN and OECD) have been published, putting forward their views on how to fix this problem. Although significant developments have been reached, no particular legislation has been implemented uniformly by a group of countries.

In our view, there are three main proposals conceptually – and may be categorised as follows:

First, creating a new nexus between a digital company and a market jurisdiction where it operates, as to allow a new taxing right to be born. It essentially means configuring a new system, coexisting with the existing corporate income tax rules, by which multinational enterprises operating within the digital economy will be subject to tax on profit. This "ecosystem" aims to attribute to a broad number of countries where the enterprises operate taxing rights in fair manner.

Second, the thesis defending that the permanent establishment must be conceptually modified or updated in order to respond to modern situations, i.e. the digital economy operators[24]. Opting for this solution, essentially a new and independent type of permanent establishment should be created to integrate digital business models proving services in source states (ring fencing the digital economy). This may be accomplished by virtue of a 'significant digital presence' test in order to create a relevant nexus with a certain territory – hence, virtual or digital PE.

Thirdly, there is the proposal of a withholding tax over payments from digital services at the source state where a digital company is operating to the non-resident beneficial owner[25]. Under current international rules, the income generated in a particular

[24] See **JOSÉ ÁNGE & GÓMEZ REQUENA**, *ibidem,* p. 736 and 740: "*To this end, the inclusion of a new nexus based on significant digital and economic presence, supported by a quantitative criterion responds, in our opinion, to the current and future context of electronic commerce and its associations with direct taxation. A virtual space can perfectly well maintain a sustainable and permanent penetration in the economy of a country, generating income that is not liable to taxation…"*

[25] See **JOSÉ ÁNGE & GÓMEZ REQUENA**, *ibidem,* p. 736: "*One option is to include a withholding tax at source on the payments made by the clients or customers of such digital products or services in the territory in which the website operates. A certain percentage of the price of the product would be deducted and deposited either by the selling company or by the consumers themselves, or, in the line suggested by the Expert Group on Taxation of the Digital Economy in the 2014 Action Plan 1 Report, by the company responsible for administering the electronic payment. This withholding tax should be duly offset using one*

country by a non-resident company, without a PE or fixed place of business, from digital services is only taxable its resident state (safe that specific domestic legislation is not in place), leaving the source State without tax revenue for the services provided to local companies and physical persons. There may not be tax imposed over the income of a non-resident company unless the business is carried through a permanent establishment or fixed place of business (which, as explained above, is not the case for digital companies).

The first model could be identified as the OECD/G20 Pillar One Blueprint; the second model resembles most with the EU's Commission directive proposal; and the third model represents the UN's Article 12B proposal for the Model Double Taxation Convention. All models have resembling elements and share identical goals, but are technically different and present different pros and cons.

On the next Chapter we will thoroughly analyse each model.

of the conventional methods to eliminate double taxation in the State of residence of the online selling company.".

2. Creation of a Multilateral-based New Taxing Right: The OECD/G20 Report on Pillar One Blueprint

2.1. General remarks

The OECD, through the Report on Pillar One Blueprint, seeks to adapt the international tax rules in an attempt to include new business models operating in the digital economy. Moreover, "adapting" means expanding the taxing rights (which are basically limited to the existence of a physical PE) of a certain country where a digital MNE has significant presence and an active participation on the local economy. By doing so the rules proposed by the OECD (if adopted) will allow smaller jurisdictions or developing countries to apply a tax and obtain fiscal revenue from the MNEs operating cross-border, fulfilling its purpose of a "fairer and more efficient" taxation[26].

Hence, the aim of changing the *status quo* may be achieved through two mechanisms:

i) specific activity tests and scoping rules to determine what business activity to tax;

ii) new element of connection with a market jurisdiction, beyond the conventional physical requirements, to know where to tax eligible companies[27].

Multinational Enterprises with special focus on digital services and consumer-facing activities are the main target of this study[28].

It is important to highlight that the economic effect of this Report is quite significant. According to the economic assessment of the OECD, depending on the definitive framework agreed upon by the countries for Pillar One and Two, these new rules could represent an increase of global CIT revenues by USD 50-80 billion per year[29]. This figure may even be higher as around 4% or USD 60-100 billion per year if Pillar Two rules coexist with the US Global Intangible Low Tax Income[30]. From a public finance point of

[26] See. OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p. 8.
[27] See *Ibidem,* p. 11.
[28] *Ibidem,* p. 12.
[29] See OECD (2020), *Tax Challenges Arising from Digitalisation – Economic Impact Assessment: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p. 10
[30] *Ibidem,* p. 14.

view governments are naturally keen to implement rules recommended by the OECD in this regard.

The OECD Report on Pillar One Blueprint also focuses on ensuring wide ranged tax certainty and stability for both taxpayers and administrations, via innovative dispute prevention and resolution mechanisms[31].

In short, the three fundamental grounds of Pillar One are:

1. **Amount A** – a new taxing right for market jurisdictions over a share of residual profit calculated at an MNE group (or segment) level that fall within its defined scope;
2. **Amount B** – a fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction, in line with the Arm's Length Principle; and
3. Processes to improve **tax certainty** through effective dispute prevention and resolution mechanisms[32].

The Amount A of Pillar One is the new taxing right proposed by the OECD to be exercised by market jurisdictions, namely where the MNE operates solely in a digital form. In practice this means that the worldwide revenue of a particular digital company could be liable to tax in the various jurisdictions it operates without having a PE, depending on the level of intensity and influence in the local economy.

The Amount B, which is not object of this study, aims at standardising transfer pricing rules applicable to intragroup distribution entities that performs functions, owns assets and assumes risks.

Tax certainty, the third element of the Pillar One Blueprint, is stated by the OECD/G20 as fundamental and crucial for the welfare of both taxpayers and tax administrations. The G20 Finance Ministers have recognised this importance and the need for international cooperation and consensus-based solution when implementing the

[31] See OECD, supra n. 45, p. 14 and 168 et. Seq.
[32] See OECD, supra n. 45, p. 11.

changes to the international tax system[33]. Thus, dispute prevention and resolution for Amount A is crucial to address, which is why Pillar One contains a clear and administrable mandatory binding dispute prevention process that would provide early certainty, before tax adjustments are made[34].

The Blueprint contains different suggestions to prevent disputes between jurisdictions over the taxing right, from which we highlight the development of a standardised Amount A self-assessment return / documentation package and centralised filing, validation, and exchange of this information, and improving the current mutual agreement procedure (MAP)[35].

Finally, the development of the implementation framework for Pillar One is at an earlier stage than other work streams. Implementation design is dependent on decision points in these areas to ensure that Pillar One can be implemented swiftly, effectively, consistently and in a coordinated manner. Requires action across three different dimensions: *(i)* domestic law; *(ii)* public international law; and *(iii)* guidance to supplement.

It is argued that the best way to remove Tax Treaty obstacles to the implementation of Pillar One and to do so in a way that ensures consistency in the application and operation of Amount A is to develop a new multilateral convention. The multilateral convention would remove existing barriers in tax treaties to the application of Amount A[36].

[33] *Ibidem,* p. 168 and Final Communiqué of the G20 Finance Ministers & Central Bank Governors meeting, 22-23 February 2020, Riyadh, Saudi Arabia (available at: https://www.mof.go.jp/english/international_policy/convention/g20/communique200223.pdf), accessed 04/05/2021.

[34] Avoiding the traditional bilateral dispute mechanisms, which in this case is particularly difficult once it is unpractical to allow all affected tax administrations to assess and audit an MNE's calculation and allocation of Amount A.

[35] See OECD (2015), *Making Dispute Resolution Mechanisms More Effective, Action 14 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, available at https://doi.org/10.1787/9789264241633-en. (accessed 04/05/2021).

[36] As bilateral tax treaties would remain in force and continue to govern cross-border taxation outside Amount A, the new multilateral convention would coexist with the existing tax treaty network.

2.2. Activity test and Threshold test

Certain key elements must be considered in the new taxing right for eligible market jurisdictions to receive Amount A: an activity test to determine whether a business has or has not a significant interaction with customers and users in a market jurisdiction, a revenue threshold based on the company's global annual consolidated revenue, the portion (in percentage) of residual profit that each country will be deemed to receive, administrative processes of simplification and coordination, and naturally mechanisms to eliminate double taxation of income[37].

Regarding the **activity test**, it is constructed upon the principle that because of the globalisation and digitalisation of the economy certain business models may prosper in a certain country by only engaging digitally with users, without any physical presence to operate sales or distribution, for example[38]. Therefore, the OECD concluded on two main types of relevant in-scope activities for Amount A: Automated Digital Services (ADS) and Consumer Facing Businesses (CFB).

Multinational enterprises generate revenue with the provision of ADS on a standardised basis to a global and multi-jurisdiction customer or user base. They do so remotely, using exclusively the internet and software, with little or no local infrastructure. These companies intensively monitories the user's data and content shared, through algorithms and artificial intelligence (AI), in order to monetise the information collected. Their benefit is higher as data and content shared between a network of users increases (phenomenon commonly referred to as Big Data)[39].

The activity test proposed by the OECD has three steps, to help tax administrations and businesses: a positive and negative list should be in effect. First, they will identify

[37] See OECD, supra n. 45, p. 12-14.
[38] See OECD, supra n. 45, p. 19 et seq.
[39] *Ibidem.* See also **R. PETRUZZI & S. BURIAK**, *Addressing the Tax Challenges of the Digitalization of the Economy – A Possible Answer in the Proper Application of the Transfer Pricing Rules?*, 72 Bull. Intl. Taxn. 4a/Special Issue (2018), Journals IBFD, p. 6 et seq., **Y. BRAUNER & P. PISTONE**, *Some Comments on the Attribution of Profits to the Digital Permanent Establishment,* 72 Bull. Intl. Taxn. 4a/Special Issue (2018), Bulletin for International Taxation IBFD, **JULIA SINNIG**, *'The Reflection of Data-Driven Value Creation in the 2018 OECD and EU Proposals'*, (2018), 27, EC Tax Review, Issue 6, pp. 326 eq seq.
Reference by the OECD to AI was already made in the previous report of BEPS, see OECD, *Tax Challenges Arising From Digitalisation – Interim Report*, 2018, OECD 2018, para. 166.

whether an activity is included on the positive list. Second, if the activity is not on the positive list, they will need to check whether it is on the negative list (being excluded from this qualification). Finally, should the activity fail to be deemed in both lists, one should analyse if it meets the conditions of a general definition: an 'automated' and purely 'digital'[40].

The positive lists included examples such as: online advertising services, sale or other alienation of user data, online search engines (Google), social media platforms (Facebook, Instagram), online intermediation platforms (Amazon, eBay, Uber), digital content services (Netflix, HBO), online gaming, standardised online teaching services, and cloud computing services (Amazon Web Services).

On the other hand, the OECD develop a broader category of enterprises operating in the digital economy described as Consumer Facing Businesses (CFB). These are businesses that generate revenue from the sale of goods and services typically sold to consumers, including those selling indirectly through intermediaries and by way of franchising and licensing. Simply nowadays these companies are able to engage with consumers in a significant way beyond the traditional local physical presence and can thereby substantially improve the value of their products and increase their sales[41].

A CFB is none other than a typical good and services supplier, with the single differential element of engaging in consumer market research, marketing and promoting it to consumers, using consumer data, or providing consumer feedback or support services.

The second test to be performed is the **threshold test**. Considering the amount of compliance costs involved in the implementation of the new rules proposed and from a cost-benefit standpoint, the OECD admits that the nexus of Amount A must be subject to a threshold test[42].

[40] See OECD, supra n.45, p. 19-20.
[41] See OECD, supra n.45, p. 20-21
[42] See OECD, supra n. 45, p. 58, also making the utmost valid point of public administrative costs: "*not just the compliance cost of the MNE but also taking into account the wider administration cost for tax*

An MNE can only be in scope of Amount A if it meets the activity test described above and two thresholds: the MNE's consolidated global revenue and its in-scope revenue earned outside its domestic market is also above a certain threshold.

This way ensuring Amount A focusses on the largest MNEs that have residual profit available for reallocation to market jurisdictions; plus, that the compliance costs for companies and administrative burden for governments is proportionate and viable to the expected tax benefits. Thus, the OECD proposes that the global revenue test for a MNE is €750M[43]. The estimated number of MNE groups with a primary activity in ADS or CFB sectors after applying the global revenue threshold is circa 2300 MNE groups[44].

However, according to the Economic Impact Assessment of the OECD when applying profitability ratios, data reveals that 'global residual profits' tend to be concentrated in a small of number of MNE groups: "*For example, assuming a EUR 750m global revenue threshold and a 10% profitability threshold percentage, about 85% of global residual profit in ADS would be concentrated* ***among 10 MNE groups*** *and about 70% of global residual profit in CFB would be concentrated* ***among 50 MNE groups***."[45]

The Report on Pillar One also proposes a *de minimis* threshold for foreign in-scope revenues. This second threshold applies to MNR groups that exceed the first global revenue abovementioned, but only have a small amount of foreign source revenue. In short it means that only MNE groups with an aggregated foreign source revenue from in-scope activities (ADS and CFB) exceeding a certain amount are taken into account for Amount A liability[46].

---

administrations that would be required to process and verify compliance for a large number of taxpayers, whether as part of the early tax certainty process or otherwise."

[43] See OECD, supra n. 45, p. 22 and 58. In line with the obligation for MNE groups to report their profit and economic activities on a country-by-country reporting, implemented by OECD/G20 BEPS Project.

[44] See OECD, supra n. 45, p. 59.

[45] See OECD, *Tax Challenges Arising from Digitalisation – Economic Impact Assessment: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p. 36-37 (our bold).

[46] See OECD, supra n. 45, p. 59. By using the term 'foreign' it implies that the business has a a domestic or home market. It shall be where the group has its headquartered or where the main holding company is tax resident, *ibidem* p. 60.

If the requirements of the two tests (activity test and threshold test) are met a **new nexus** with a market jurisdiction is created, one that is not relying on a physical element of connection (the permanent establishment)[47].

As described above, the aim is to attend to smaller jurisdiction's interests, particularly developing countries, giving them a legal attribution to tax income from ADS and CFB type companies.

For Automated Digital Services, a company would be subject to Amount A if it exceeds a global revenue threshold (€750M) providing in-scope services, with the key justification that the company engages significantly with the market jurisdiction. However, the nexus would have to be slightly adapted to CFB business models.

A higher nexus standard would be desirable for CFB because an MNE may already have a conventional PE or even a well-established company of the group in a certain market, *i.e.* a factory producing goods, an industry, distribution and storing facilities, brick-and-mortar shops doing sales, after-sales support, or human resources providing services to the local economy. Therefore, the ability to participate remotely in a market jurisdiction, in principle, is not as evident or significant an ADS company. This coupled with the fact that in CFB there may be additional complexity and compliance costs associated with sourcing revenue (namely third-party distribution) and naturally profit margins are usually lower that ADS. All these reasons justify a higher nexus to be required for CFB for it to be eligible to Amount A.

Hence Pillar One suggests higher thresholds and the existence of "plus factors" to strengthen the nexus with market jurisdictions, such as: a subsidiary, a PE according to UN and OECD convention model definitions or a requirement that the aforementioned are carrying out activities directly related with the in-scope activities.

Summing up, for Consumer Facing Businesses a company would be subject to Amount A it exceeds a global revenue threshold (€750M) providing in-scope services

[47] See OECD, supra n. 45, p. 64 et seq. In fact, besides the market revenue thresholds, a temporal requirement is also being contemplated. A duration test could be designed by requiring that the market revenue threshold be exceeded over a period spanning more than one year before establishing a nexus.

and the verification of a "plus factor" (namely a subsidiary or a permanent establishment providing activity related services in the market jurisdiction).

2.3. Tax Base Determination

Once an MNE group is deemed to have the new nexus verified with one or more market jurisdictions, the tax base for Amount A must be determined. The starting point is the consolidated group financial accounts[48].

The Report on Pillar One Blueprint sets rules and guidance for the Amount A tax base determination, ensuring net-basis taxation. Briefly, these set of rules will include:

- **Eligible consolidated financial accounts:** no specific accounting standard will be required, however; therefore, the financial accounting standard used by the UPE in the preparation of its consolidated financial statements will be used[49]. To avoid more compliance costs, and considering the different accounting rules across countries, the generally accepted accounting principles (GAAP) should be followed by MNE groups under the condition that comparable outcomes are fulfilled under International Financial Reporting Standards (IFRS)[50].
- **The standardised Profit Before Tax (PBT) definition:** Amount A tax base will start from the total profit or loss before tax figure from the MNE group's consolidated accounts, as it is considered the most appropriate benchmark and most similar to CIT base. Adjustments (*i.e.* book-to-tax expenses) consistent with Pillar Two will be accepted.
- **Segmentation framework:** it may be necessary to compute the tax base on a segmented basis because Amount A will apply only to the profits that

[48] See OECD, supra n. 45, p. 98.
[49] However, the Report admits that further work in terms of harmonisation will have to be develop in what regards the solution to the various accounting standards MNE groups are subject to in different countries when preparing the consolidated financial accounts.
[50] The International Financial Reporting Standards are a set common rules so that financial statements can be consistent, transparent, and comparable around the world. For more information see https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/ (accessed 30/04/2021)

groups derive from carrying on in-scope activities. For the scope and nexus rules, taxpayers will need to separate their revenue between that attributable to CFB, ADS and out-of-scope activities.

- **Loss carry-forward rules:** Any losses arising from a taxable period will be preserved and carried forward to subsequent years through an "earn-out" mechanism[51].

2.4. Profit Allocation Rules

Once the nexus is established with the market jurisdiction and the tax base of a MNE group is properly defined the next step is to calculate and allocate profits to market jurisdictions accordingly. The Pillar One Blueprint defends a formulary approach, not based on the arm's length principle[52].

The construction involves a three-step process:

- **Step One:** A profitability threshold to isolate the residual profit potentially subject to reallocation and limit any interactions between Amount A and the remuneration of routine activities under conventional transfer pricing rules. This threshold will more likely be based in a profit margin approach, which translates into a PBT to revenue ratio[53] - although a "profit-based approach" using absolute number is also considered[54];
- **Step Two:** A reallocation percentage to identify an appropriate share of global residual profit that can be allocated to market jurisdictions under Amount A (hereafter, the "allocable tax base"), considering that MNE groups perform other activities unrelated to Amount A that generate profits taxed under existing ALP-based profit allocation system[55]; and

[51] For more in depth analysis, see OECD, *Tax challenges ...,* p. 111 et seq.
[52] *Ibidem,* p. 120.
[53] According to the Economic Assessment, between 8% to 25%, p. 123. With the PBT to revenue ration of 8%, circa 990 MNE groups carrying out ADS and CFB would be subject to Amount A, with an estimated global residual profit of USD 600 billion.
[54] For example, the calculation of Amount A tax base would start at profit above USD 10 million.
[55] This percentage is fixed quite arbitrarily, through convention. The economic assessment shows percentages ranging from 10% to 30%. Applying a allocation percentage of 10% to the MNE groups within

- **Step Three:** An allocation key to distribute the allocable tax base amongst the eligible market jurisdictions (i.e. where nexus is established for Amount A). It will be based on the local in-scope revenue, and determined by applying the rules on scope, nexus, and revenue sourcing.

Under these rules and for the purpose of illustration, based on a 10% profitability threshold (step one) and a 20% reallocation percentage (step two), the economic impact assessment suggests that around USD 50 billion would be allocated to market jurisdictions in ADS and CFB businesses[56].

In this regard, and before going into detail about the formula above mentioned, Pillar One addresses specifically the '*marketing and distribution profits safe harbour'*, which is an integrating rule of the Amount A formula designed to mitigate the problem of double counting, beyond the mechanism to avoid double taxation[57]. It aims to protect the taxpayer from the new tax when it already allocates and earns profits under existing transfer pricing rules.

The marketing and distribution profits safe harbour will limit or adjust the allocation of Amount A from market jurisdictions to MNE groups that already leave sufficient residual profit in the market under existing profits taxing rules. However, the group will remain subject to the existing rules, including on transfer pricing and the elimination of double taxation. A taxable presence in the market jurisdiction relevant for the safe harbour rules implies having marketing and distribution activities directly linked with local in-scope revenue (subsidiary or PE) and paying the respective income taxes respectively.

The '*safe harbour return'*, according to Pillar One, will consists of Amount A (calculated under the formula) and of a yearly fixed return for in-country marketing and distribution activities. Three outcomes are possible, if the existing marketing and distribution profits are:

(i) lower than the fixed return, the MNE group will not be eligible for the safe harbour, thus the full Amount A shall be allocated;

---

the profitability ratio of 8% (i.e. circa 990) around USD 60 million would be allocable to market jurisdiction, see p. 124

[56] Economic assessment, p. 37

[57] OECD, Tax …, p. 121 and 129 et seq.

(ii) higher than the fixed return, but falls below the safe harbour return, the quantum of Amount A allocated to that jurisdiction would be reduced to the difference between the safe harbour return and the profit already allocated to the local presence; and

(iii) higher than the safe harbour return, no Amount A would be allocated to that jurisdiction.

By integrating this safe harbour in the calculation of Amount A the Pillar One Blueprint refers that, in some cases, it may reduce pressure of the mechanisms to avoid double taxation, once it is a preliminary element.

2.5. Avoiding Double Taxation

The new taxing right at a group level will coexist with the current international tax rules regarding profit allocation, i.e., transfer pricing. Therefore, the Pillar One Blueprint foresees a method to identify the entity within MNE group (or segment) liable to pay the tax and the double taxation reliefs applicable to the remaining entities of the group.

In essence these rules intend to determine which entity or entities within a group sustain the material contributions for the MNE to generate residual profits[58] (activity test) and have the financial capability of paying the Amount A (profitability test[59]). A pro-rata allocation formulaic-based rule is also thought of, whereby if the paying entities connected to a market do not have enough profits to pay the full Amount A tax, then as a "back-stop" any outstanding liability will be apportioned between all other potential paying entities within a segment[60].

---

[58] These activities shall go beyond the mere ownership of relevant marketing intangibles, and actually include software to help boost sales or control of economically significant risks and business-related decisions. The Report sets forth the following principle for this purpose, in line the current transfer pricing framework: *"the member or members of an MNE group (or segment) that perform functions, use or own assets and/or assume risks that are economically significant, for which they are allocated residual profits relevant to Amount A",* see. OECD, *Tax Challenges*…, p. 141.

[59] This test seeks to carve-out entities generating low profits (or reporting losses), despite conducting important activities as per the previous test. The profitability will be tested as above a certain amount accounted for two factors: payroll and tangible assets.

[60] See **OECD**, *Tax Challenges…,* p. 146.

The methods to eliminate double taxation (exemption and credit) will ensure that a paying entity is not subject to any tax twice over the same profits in different jurisdictions, firstly under the existing profit allocation rules and secondly under Amount A.

In the case of the Pillar One Blueprint, the exemption method will relieve the paying entity from tax on the portion of profits that was allocated by the Amount A formula. Regarding the credit method, the paying entity liable to the Amount A tax in a certain market jurisdiction will have a tax credit, applied either by a jurisdiction-to-jurisdiction approach or by a blended approach. The former implies that the "limit on the credit is determined by comparing the tax that would have been paid in the relieving jurisdiction to the tax applied to Amount A in each market jurisdiction separately"; while the latter "would be determined by comparing the tax that would have been paid in the relieving jurisdiction to the tax applied on the total Amount A liability allocated to each paying entity"[61]

2.6. Amount B

The Pillar One Blueprint develops the Amount B, which is a new taxing right such as Amount A, but rather an attempt to standardise revenue from in-group related parties regarding marketing and distribution activities, along the lines of the arm's length principle. It aims at simplifying transfer pricing rules for tax administration and taxpayer (reducing compliance costs) and, secondly, is intended to enhance tax certainty and reduce controversy between tax administrations and taxpayers[62].

In short, Amount B is the remuneration of group enterprises resident in (or in the case of a permanent establishment located in) a market jurisdiction (either a subsidiary or a PE) that perform baseline marketing and distribution activities for the distribution of products for the MNE group. The key element to define if an entity carries out these

[61] See **OECD**, *Pillar One,* p. 150.
[62] See **OECD**, *Tax Challenges …,* p. 155.

baseline activities is if it "performs functions, owns assets and assumes risks" that would characterise it as a routine distributor at arm's length[63].

The *quantum* element is structured as the fixed return provided to remunerate baseline marketing and distribution activities under Amount B and intends to produce a result closer to those determined in accordance with the Arm's Length Principle. However difficult to agree upon a benchmark, implementing Amount B in a coordinated and uniform fashion will reduce the risk of double taxation for taxpayers and double non-taxation for governments.

It would need to be implemented in three steps: 1) first, implementation of Amount B may need to be effectuated under domestic law or regulation; 2) second, although two jurisdictions with an existing tax treaty can resolve disputes over Amount B through that treaty, where there is no treaty in place, a new treaty-based dispute resolution relationship may be required; 3) third, guidance to accompany domestic legislation and treaty provisions may be required, although the narrower approach to scope may again limit this requirement.

[63] *Ibidem,* p. 157. Examples of baseline functions: Importation of products for resale within the market and customs clearance, purchase of goods for resale within the market, marketing activities, etc. Examples of baseline assets: ownership/lease of offices, customer list/customer relationships for their own local customer relationships, local registrations or licences for products, etc. Examples of baseline risks: limited risks, developing strategic marketing plans, defining prices and undertaking brand development activities, etc.

3. Adapting the Existing International Tax System: A Withholding Tax on Digital Services

3.1. General remarks

As we have tried to explain, conceptually we are of the opinion that designing a new normative system for the digital economy (ring-fencing the digital economy) overlapping current rules is not the appropriate way to move forward, in terms of effectively taxing highly digitalised companies.

Using the current institution of the withholding tax in tax treaties and adapting it to this new reality will be more practical for taxpayers and tax administrations, will deliver the wanted outcomes and ensure a systemic cohesion of the international tax framework[64].

Hence, currently we believe that the proposal of the UN for the introduction of the Article 12B to the model tax convention is a more reasonable reform (in terms of tax policy and political agreement) and would be the most beneficial for the interested parties, for various reasons. This article would apply to digital services provided by a company, regardless of being a traditional brick-and-mortar or a pure e-commerce businesses.

Some of the advantages of the proposal that may be highlighted (in comparison to Amount A) are: 1) as the conventions have a bilateral nature it will not end in multilateral chaos; 2) it has diminutive interaction with the current system; and 3) countries preserve their sovereignty that would be jeopardised otherwise[65].

Let us analyse in detail the proposal for Article 12B.

[64] In this sense, see the important and pioneer contribute of **A. BAÉZ MORENO & Y. BRAUNER**, *Withholding Taxes in the Service of BEPS Action 1: Address the Tax Challenges of the Digital Economy*, p. 4 (2015), White Papers IBFD, 1-33.

[65] See **T. EISGRUBER, S. GREIL**, *'Policy Note: Taxing the Digital Economy: A Case Study on the Unified Approach'*, …, p. 66.

3.2. The Proposal of the UN to Add Article 12B to the Model Tax Convention

According to recent reports, the UN will introduce the Article 12B to the model tax convention to avoid double taxation, whereby a Contracting State could impose a new limited withholding tax to a non-resident automated digital services provider, based on the income derived therein and paid to the resident of the other Contracting State[66]. This way, similarly to other types of income, the taxing rights will be shared between Contracting States according to their negotiations and the methods to avoid double taxation shall be available[67].

The main features of the article are the following:

- **Tax Sovereignty**: Being a provision regarded in a tax treaty, its nature is purely to regulate international rights (setting limit withholding taxation), therefore countries will be free to pass their own domestic legislation levying taxes (regarding scope, exemptions, tax base determination, rates) to income derived from digital business models. Besides, the Pillar One foresees a binding dispute resolution rule[68] which may be seen as an attack of the sovereignty and judicial system of a country, whilst in the case of the UN the model tax convention foresees mechanisms to resolve cross-country disputes, such as MAP and arbitration[69].

---

[66] See **UN**, Committee of Experts on International Cooperation in Tax Matters, *Tax Consequences of the Digitalised Economy – Issues of Relevance for Developing Countries*, E/C.18/2020/CRP.41, 10/10/2021, available at https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-10/CRP41_Digitalization%2010102020A_0.pdf, accessed at 12/05/2021 (hereinafter, **UN**, *Article 12B Proposal*).

[67] **UN,** *Article 12B Proposal,* p. 9, the article, under the epigraph "Income From Automated Digital Services" establishes:
"1. Income from automated digital services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.
2. However, subject to the provisions of Articles 8 and notwithstanding the provisions of Article 14, income from automated digital services arising in a Contracting State may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the income is a resident of the other Contracting State, the tax so charged shall not exceed ____ percent *(the percentage is to be established through bilateral negotiations)* of the gross amount of the income from automated digital services.

[68] See above 3.4.

[69] See UNMDTC, Article 25.

- **Negotiation basis**: the proposed Article 12B allows a Contracting State to tax income from certain digital services paid to a resident of the other Contracting State at a negotiable rate agreed between two countries (paragraph 2). Bilateral agreements ensure countries have negotiating powers and come together to reach a consensus attending to their individual interests, in this case characterised by the withholding tax posed and tax base principles. We believe this approach greatly guarantees a fair and equal outcome, unlike a consensus proposed in Pillar One where the voice of smaller or developing countries will not be heard. Countries with stronger political influence will set the rules in discrimination of developing countries.

- **Equality and Fairness for Taxpayers**: There are no minimum economic thresholds or conditions for this article to apply. The tax is not dependent on exceeding certain revenue amounts (or profitability ratios) by entities, having a PE or being present a minimum period in a Contracting State. This poses as a great positive aspect of the proposal contributing to the equality principle of taxation[70] whereby tax at the source may be levied if value is created, as well as enhancing the simplicity element[71].

- **Choice Between Gross and Net Income Taxation**: Paragraph 2 states that withholding tax (at the negotiated rate) will apply to gross income derived from ADS[72]. Although the gross basis taxation is not desired and may therefore well be criticised[73], the article however safeguards the preference to use the net principle to determine the taxable profits. Paragraph 3 unveils the possibility of the beneficial owner of ADS income to require taxation on a net basis under a Contracting State's domestic tax law to "qualified profits". These being 30% of the amount

[70] Unlike Amount A, whereby compliance and administrative costs are so high that in reason of equity and proportionality principles, companies with lower amounts of revenue should not be subject to the same rules. However this is not a fair and equal system.
[71] See **M.R. ASTUTI**, *Three Approaches*…, p. 726.
[72] See footnote 152 above.
[73] See for example **ANA PAULA DOURADO**, *Editorial: The OECD Report on Pillar One Blueprint and Article 12B in the UN Report …,* p. 4.

arrived at by applying global profitability ratio of the beneficial owner's automated digital business to the gross annual revenue derived from ADS in a particular Contracting State[74-75]. Hence the gross revenue will work only as a pre-condition to opt for net taxation. When countries negotiate tax administration and taxpayers are the primary interested in ensuring net basis taxation and coordinating this in a bilateral fashion is much simpler. Further developments however should be made to make sure countries agree to set this rule as a norm (for example, standardising accounting rules to mitigate mismatches between countries' accounts).

Indeed, this option would provide relief in those cases where the taxpayer may have a lower tax liability than the liability determined as per withholding tax mechanism as also in cases where it has a global business loss or a loss in the relevant business segment during the taxable year[76]. Choosing the net taxation, qualified profits shall be taxable at the tax rate provided in domestic law of the Contracting State. So as to facilitate net basis taxation of income from ADS, the domestic law will have to foresee registration procedures of such service providers and respective tax declaration forms to be filed. If the option of para. 3 is not opted for, similarly to other articles of the Convention Model, taxes withheld at source would be considered against the tax liability determined on net basis in the Resident State.

[74] In case the beneficial owner does not use segmented accounts (to know revenues from sales, automated digital services, etc), the overall profitability ratio shall be used. As written on para. 3: "Notwithstanding the provisions of paragraph 2, the beneficial owner of the income from automated digital services may request the Contracting State where such income arises, to subject its qualified profits from automated digital services for the fiscal year concerned to taxation at the tax rate provided for in the domestic laws of that State. If the beneficial owner so requests, the taxation by that Contracting State shall be carried out accordingly. For the purpose of this paragraph, the qualified profits shall be 30 percent of the amount resulting from applying the profitability ratio of that beneficial owner's automated digital business segment to the gross annual revenue from automated digital services derived from the Contracting State where such income arises. Where segment-wise accounts are not maintained by the beneficial owner, the overall profitability ratio of the beneficial owner will be applied to determine qualified profits. However, where the beneficial owner belongs to a multinational enterprise group, the profitability ratio to be applied shall be that of the business segment of the group relating to income covered by this Article, or of the group as a whole in case segment-wise accounts are not maintained by the group, provided such profitability ratio of the multinational group are higher than the aforesaid profitability ratio of the beneficial owner."

[75] Such implies disclosure of consolidated financial statements.

[76] See **UN**, *Article 12B Proposal*, p. 16.

- **Simplicity**: A withholding tax imposed on the gross amount of payments made by residents of a country, or non-residents with a PE, is a well-established and effective method of collecting tax. Such method may also simplify compliance for enterprises providing services in another State since they would not be required to compute their net profits or file tax returns unless they opt for net income basis taxation. Many developing countries have limited administrative capacity and need a simple, reliable, and efficient mechanisms to enforce taxes on income from services derived by non-residents. Although not perfect of a system (as we will emphasise after) but compared to Amount A calculation and profit allocation rules, the digital PE proves to be a more straightforward model.

- **Avoiding Double Taxation Aspect**: Although the rate is bilaterally negotiated, this may be mitigated by having a modest rate (UN's recommendation is 3% to 4%) of tax on income from ADS. This is justified by the fact that taxes on revenue may result in excessive or double taxation. Additionally, the convention's methods to eliminate double taxation (article 23) are to be applied: the residence country of the taxpayer is required to provide relief from double taxation, via exemption from tax of the foreign-sourced ADS income or via granting a credit against tax payable to the residence country on ADS income for any tax imposed on such income by the other Contracting State in accordance with Article 12B.

- **Limited force-of-attraction rule**: As per paragraph 5, if a resident of one Contracting State provides ADS through a PE located in the other Contracting State and the income derived is effectively connect with such PE, the payment received for those services will be taxable by the State in which the PE is located, in accordance with Article 7 or Article 14. Taxation under paragraphs 1, 2 and 3 is untriggered when the ADS-based

revenue is effectively connected with business activities of an already existing PE, prevailing article 7 of the UNMDTC[77].

- **Protection of the Arm's Length Principle**: Paragraph 8 sets a rule with the aim to restrict excessive payments between entities with special relationships. When a payment from ADS between special relationship entities exceeds the price that would have been agreed upon by the same entities if they were independent from each other (at arm's length), the provisions of this Article will only to the last-mentioned amount[78]. The excess part of the payments for automated digital services would remain taxable according to the laws of the two Contracting States.

Additionally, the proposal, similarly with the Pillar One approach, moves forward with the option of formulary profits' apportionment (however simpler), by allowing a Contracting State to tax income using a 30% allocation of net income, diverging from the rules at ALP for geographical profit allocation.

Overall, this proposal of the UN is, in our opinion, remarkable because with considerably less efforts than the OECD[79], presents a straightforward solution to be used by countries (especially developing countries) with the aim of taxing digital companies with no physical presence in a market jurisdiction. Weight is put on integration with the current international tax system instead of disrupting innovation. Another deep difference to the OECD's proposal is the burden to tax administrations and compliance costs to taxpayers, which are relatively low with the use of a withholding mechanism[80].

---

[77] See commentaries of this paragraph, at **UN**, *Article 12B Proposal*, p. 25 et. seq.

[78] *Ibidem,* p. 27.

[79] See **H. VAN DEN HURK,** *OECD's Pillar One and the Return of the Pencil!*, Kluwer Intl. Tax Blog (22 Feb. 2021), available at http://kluwertaxblog.com/2021/02/22/oecds-pillar-one-and-the-return-of-the-pencil / (accessed 21 Apr. 2021), for a comical analogy between the two institutions' approach to the digital economy taxation challenge.

[80] See **M.R. ASTUTI**, *Three Approaches…*,p 726, highlighting summarily some advantages of the proposal: *"The new draft article 12B of the UN Model would provide more benefits for developing countries, given its simplicity. It could also provide for taxing rights in respect of all market jurisdictions, regardless of the amount of sales. The allocation of 30% income to be taxed by the market country would be most likely greater than the portion of the residual profits allocated under the Pillar One unified approach. Moreover, the use of the withholding tax mechanism could reduce the administration costs for MNEs and tax administrations alike."*

In our opinion this draft may still suffer changes to perfect the model, maybe on the qualified profits percentage (30% as it stands), either changing this number or leaving it in a negotiable ground for countries to agree themselves.

4. Redefinition of the Permanent Establishment: The Digital PE

4.1. General remarks

As mentioned above, and following the OECD/G20 BEPS Project[81], the current PE definition of the OECD Model Tax Convention requires adjustments at a structural level in order to appropriately address new business models born out of the digital economy development. The BEPS project published a report which exposed the challenges in taxation of the digital economy, the Action 1, and specifically brought up the theoretical solution of a virtual Permanent Establishment. However, as we have studied, it seems this option was abandoned by the OECD in search of a new taxing right over residual global profits[82].

The Digital PE theory focuses on redefining the nexus established between a non-resident company and a particular jurisdiction, based on a significant digital presence. It responds to the problem of non-resident entities being economically engaged with an economy without fulfilling the requirements of a fixed placed of business (or any other form of a PE), so that a profits' taxation is enabled by article 7 of the OCED model.

The pioneers in this theoretical construction were Professors P. HONGLER and P. PISTONE in an article, which, according to their words "*focuses on how the PE concept can be changed in a way that adapts its boundaries to the new scenario of the digital economy without losing the traditional function that such concept has played in international taxation over several decades"*[83]. Their motivation was to tackle base erosion practices from non-resident companies operating tax free in the economy because of the highly digitalised nature and the boundaries of the PE definition.

They contributed with a formula that could be implemented via inclusion of another paragraph in the conventional PE article (5), present in all tax treaties countries have signed. The wording was the following:

---

[81] See **OECD**, *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, 2015, OECD Publishing, Paris, and OECD, *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, 2015, OECD Publishing, Paris.

[82] See title 2 of chapter two.

[83] **P. HONGLER & P. PISTONE**, *Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy*, 2015, IBFD White Paper, available at https://ssrn.com/abstract=2586196 (accessed 10/01/2020), p. 11.

> *"If an enterprise resident in one Contracting State provides access to (or offers) an electronic application, database, online marketplace, storage room or offers advertising services on a website or in an electronic application used by more than 1,000 individual users per month domiciled in the other Contracting State, such enterprise shall be deemed to have a permanent establishment in the other Contracting State if the total amount of revenue of the enterprise due to the aforementioned services in the other Contracting State exceeds XXX (EUR, USD, GBP, CNY, CHF, etc.) per annum."*[84]

This proposal already included the most important elements of the more modern proposal put forth in the scientific community and by political agents, being those: (i) a scope definition of digital services, (ii) thresholds of application, both of revenue and individual users, and (iii) a timeframe of 12 months.

The user's threshold very important as is built upon the idea that users of digital platforms, whether social media or online marketplaces, create or increase the true economic value of the company – therefore the more users interact with a digital platform the more significant a digital presence is, and vice-versa. There is an ongoing discussion in literature so as to understand if this user-based value creation should (or can) influence the profit allocation of companies in the respective operating countries. We will go into this matter latter on.

The notion of a significant digital presence evolved as we will study in the next subtitle. It eventually integrated a EU's Commission directive proposal to introduce a Digital PE in the European Union's tax law.

4.2. The '*Significant Digital Presence'* Test

As mentioned before, the international tax rules were not designed to address the way companies operate in the digital economy. Effectively, under all the signed conventions to avoid double taxation between States, the articles referring to the PE, profit's allocation and taxation is simply not applicable to companies operating on a specific market

[84] *Ibidem,* p. 25.

digitally[85]. Therefore various authors and commentators urged the need to reform the PE concept in order to integrate conventional and digitalised businesses[86].

Indeed the foundation of the Digital PE's nexus is largely based on the visionary contribution developed by P. HONGLER and P. PISTONE[87]. The OECD on the Action 1 report also developed this idea of creating the nexus based on either revenue, digital or user related factors[88]. Finally the EU seems to prefer this option as a Directive was proposed by the Commission in this sense[89], with the special advantage of this instrument being its direct implementation in each Member-states legislation without need to adapt existing tax treaties[90]. In our opinion, this is indeed a viable long-term measure.

The significant digital presence is the connection, for tax purposes, between the non-resident company operating cross boarder digital services and a certain jurisdiction[91]. According to a modern interpretation of the benefit theory, States should be entitled to

---

[85] See JOSÉ ÁNGE & GÓMEZ REQUENA, *Adapting ...,* p. 734 where the authors make the important note that the commentaries of the OECD Model Convention expressly say that a website is not a PE: "*The reality is that companies may have a significant digital presence in a tax jurisdiction thanks to ICT (mainly through the Internet), but this presence is insufficient to be considered taxable. This situation stems from the stalemate created by their denying that the webpage meets the requirements of fixity to be regarded as a PE, according to the Commentaries on the OECD MC since the 2003 reform. A web site is a combination of software and other non-material electronic data, lacking the physical nature, which, from the conventional perspective, may serve to carry out economic activity."*

[86] See, amongst others, **PETER HONGLER & PASQUALE PISTONE**, *Blueprints for a New PE Nexus to Tax Business Income in the Era of Digital Economy,* IBFD, Working Paper (2015), **E.G. PASQUALE PISTONE & YARIV BRAUNER**, *Adapting Current International Taxation to New Business Models: Two Proposals for the European Union*, 71 Bull. Intl. Taxn. 12 (2017), Journal Articles & Opinion Pieces IBFD, **A. BAÉZ MORENO & Y. BRAUNER**, *Withholding Taxes in the Service of BEPS Action 1: Address the Tax Challenges of the Digital Economy*, p. 4 (2015), White Papers IBFD, **M. OLBERT & C. SPENGEL**, *International Taxation in the Digital Economy: Challenge Accepted?,* 9(1) World Tax Journal 4 (2017), **L. U. CAVELTI, C. JAAG & T. F. ROHNER**, *Why Corporate Taxation Should Mean Source Taxation: A Response to the OECD's Actions Against Base Erosion and Profit Shifting*, 9(3), World Tax J. 352, 354 (2017).

[87] *Ibidem.*

[88] See OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, ...,* at p. 107 to 111.

[89] See **EUROPEAN COMMISSION**, *Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence*, Brussels, 21 Mar. 2018 COM (2018) 147 final 2018/0072 (CNS), available at https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_significant_digital_presence_21032018_en.pdf (accessed at 05/07/2019).

[90] See page 2 and 3 of the abovementioned Directive, "*This Directive, once implemented in Member States national legislation, will apply to crossborder digital activities within the Union, even if the applicable double taxation treaties between Member States have not been modified accordingly.*"

[91] See **ANA PAULA DOURADO**, *'Debate: Digital Taxation Opens the Pandora Box: The OECD Interim Report and the European Commission Proposals'*, (2018), 46, Intertax, Issue 6, pp. 571, also pointing that *"These solutions assume that digital companies can easily avoid residence in high-tax jurisdictions and, at the same time, anti-abuse rules will not be easily applied."*

tax a digital company because, despite the fact of not having a physical presence, owning tangible assets or having a workforce in that country, the provision of digital services rely on crucial state-regulated factors such as a stable legal system, the enforcement of payments, the supply of energy, protection of intellectual property rights, maintenance of digital environment or infrastructure[92].

There are certain key criteria to ascertain this nexus, mostly based on the virtual involvement and activity of both company and users. This is materialised in number of users (not consumers) interfacing with a digital platform or website[93], number of business contracts concluded between the digital company and local users, and amount of digital-related revenue generated in the given country. Non-revenue-based factors express the relationship between user and company, which may be identified firstly by the company's local domain name and website in a country, as well as payment option. The monthly active users of the platform, the amount and quality of the data collected by the enterprise from its local users is also determining for the nexus[94].

This is an approach that will need absolute numbers as to how many users or how many contracts and how much of a revenue will be deemed reasonable to create the nexus.

In terms of profit allocation the Digital PE model there are different possible outcomes, ranging from a formulary apportionment of the tax base to profit slip method based of transfer pricing guidelines[95], safe that in case of the latter the definitions of functions, assets and risks (FAR) would have to be reconfigured[96]. In P. HONGLER and P.

---

[92] See **PETER HONGLER & PASQUALE PISTONE**, *Blueprints for a New PE Nexus to Tax Business Income in the Era of Digital Economy* …, pages 19 to 22. Also see **CRAIG ELLIFFE**, *Justifying Source Taxation in the Digital Age,* VUWLR (Forthcoming), April 25, 2021, Available at SSRN: https://ssrn.com/abstract=3833990 (accessed 08/06/2021), pages 16 and 17.

[93] *Ibidem,* p. 24: *"The problem of having a customer-based and not a user-based threshold is that the customer-based threshold has a less closer link to the benefit obtained in a certain jurisdiction and is therefore less in line with the present rationale*".

[94] See **OECD**, *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*,…, pages 107 to 111. And **L. U. CAVELTI, C. JAAG & T. F. ROHNER**, *Why Corporate Taxation Should Mean Source Taxation: A Response to the OECD's Actions Against Base Erosion and Profit Shifting*, 9(3), World Tax J. 352, 354 (2017), pages 366 to 368.

[95] See **PETER HONGLER & PASQUALE PISTONE**, *Blueprints for a New PE Nexus to Tax Business Income in the Era of Digital Economy* …, p. 32-33.

[96] See **LISA SPINOSA, VIKRAM CHAND**, *'A Long-Term Solution for Taxing Digitalised Business Models: Should the Permanent Establishment Definition Be Modified to Resolve the Issue or Should the Focus Be on a Shared Taxing Rights Mechanism?*' (2018) 46 Intertax, Issue 6/7, p. 492-493. And **M. OLBERT & C. SPENGEL**, *International Taxation in the Digital Economy: Challenge Accepted?...,* p. 37.

PISTONE'S proposal, having this considered and in line with the economic principles, they suggested a modification of the existing profit split method with an upfront allocation of a partial profit to the market jurisdictions[97]. Furthermore, according to this thesis, market jurisdictions where a digital PE is deemed verified should have allocated between them one third of the profits based on a ratio between domestic and global revenues[98]. It may well be possible that dozens of countries have to share this "piece of the pie", potentially causing distortions. The remaining two thirds are to be split using existing transfer pricing rules. As the authors mentioned, they do not intend to totally deviate from the ALP but want to introduce a more formulaic approach to base determination[99]

One must point out that, in what regards implementation, there are two main possibilities: individual Tax Treaty amendments or collective approval via MLI or EU Council Directives. The latter is potentially the most effective and desired (and thus defended by the authors) as once a consensus regarding the digital PE (or the significant digital presence test) is reached, enforcement and elimination of double taxation would be greatly ensured via a multilateral implementation[100]. Similar results are reached namely with a EU Council Directive approval and subsequent transposition to each Member-States' domestic legislation[101].

4.3. The EU Commission's Directive Proposal

In an effort to fundamentally change this paradigm, the EU Commission put forth two Directive proposals which include new rules to make sure that the digital business activities are subject to tax, in a fair way throughout the internal market shared between

[97] See **PETER HONGLER & PASQUALE PISTONE**, *Blueprints for a New PE Nexus to Tax Business Income in the Era of Digital Economy* …, p. 34.
[98] *Ibidem,* p. 34.
[99] *Ibidem,* p. 35.
[100]
[101] See **EUROPEAN COMMISSION**, *Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence*, whereas (4): "*In this regard, Member States should be required to include rules in their national corporate income tax systems in order to exercise their taxing rights. Therefore, the various applicable corporate taxes in the Member States should be clarified. These rules should extend the definition of a permanent establishment and establish a taxable nexus for a significant digital presence in their respective jurisdictions*."

the Member-States. The proposal relevant to this thesis regards the long-term solution: a corporate tax reform[102].

The proposal has two main approaches: (i) to establish new rules of determining the taxable nexus of non-resident digital businesses – the significant digital presence; and (ii) to fix profit allocation guidelines for Member-States, as the value creation relies mostly on intangible assets[103].

Following the theoretical formulation of P. HONGLER and P. PISTONE, the proposal in constructed with three criteria in order to determine if an entity providing digital services has a significant digital presence in a Member-State:

1. Revenue: over EUR 7,000,000 turnover in the Member-State within one fiscal year;
2. Users: over 100,000 in the same period;
3. Contracts: over 3,000.

According to the EU Council Directive proposal if one of these conditions is met a significant digital presence is deemed to exist. It also included a number of definitions that are necessary to ensure a clear application[104].

Interestingly, in what concerns profits allocation to Member-States the EU's view was to base it on the arm's length principle, however with new orientations for the functional analysis. As said on note (7) of the proposal: "*Since economically significant*

---

[102] As oppose to a short-term solution (also referred as a *interim* solution) of a digital services tax on revenues, see **EUROPEAN COMMISSION**, *Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services*, Brussels, 22 Mar. 2018 COM (2018) 147 final 2018/0073 (CNS), available at https://data.consilium.europa.eu/doc/document/ST-7420-2018-INIT/en/pdf (accessed at 05/07/2019), and **EUROPEAN COMMISSION**, Directorate-General of Taxation and Customs Union, Platform for Tax Good Governance: *Short-Term Solutions to Tax the Digital Economy*, Brussels, 18 Oct. 2017, Doc Platform/30/2017/EN, https://ec.europa.eu/taxation_customs/sites/taxation/files/dig_tax_disc_pap_short_term_sol_en.pdf. Naturally the EU Commission stresses the fact of strengthening the internal digital market: "See "*A key objective of this Directive is to improve the resilience of the internal market as a whole in order to address the challenges of taxation of the digitalised economy*.", in **EUROPEAN COMMISSION**, *Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence*, whereas (8).

[103] See **GEORG KOFLER, JULIA SINNIG**, *'Equalisation Taxes and the EU's 'Digital Services Tax''*, (2019), 47, Intertax, Issue 2, pp. 176-200.

[104] See **EUROPEAN COMMISSION**, *Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence*, …, article 3.

activities performed by a significant digital presence contribute in a unique manner to value creation in digital business models, the profit split method should normally be used for arriving at a fair allocation of profits to the significant digital presence."[105].

The most appropriate (an elected) method to ensure a fair taxation in the EU's Commission view is the profit slip method, by which the profits attributable to the significant digital presence are those that would have been earned if it had been a separate and independent enterprise performing the same or similar activities under the same or similar conditions[106-107]. The underlying principles remains to be, therefore, the authorised OECD approach.

However, because "*the criterion of significant people functions relevant to the assumption of risk and to the economic ownership of assets in the context of digital activities is not sufficient to ensure a profit attribution to the significant digital presence that reflects the creation of value*" the framework requires a technical update from the traditional PE rules[108].

Thus, certain factors will have to be taking into account besides the functions performed, the assets used, and the risks assumed (FAR). Special emphasis is given to digital interface of data and users, through a functional analysis. To determine the functions performed by the non-resident entity, the economically significant activities cannot be overlooked and will have to include a digital interface related to data or users. These include the DEMPE functions, i.e., development, enhancement, maintenance, protection and exploitation of the enterprise's intangible assets shall be accounted for[109]. The splitting factors suggestions to better reflect the digital economy's specific features

---

[105] See **EUROPEAN COMMISSION**, *Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence,* whereas (7).

[106] *Ibidem,* article 5. And see **A.S. SAMARI,** *"Digital Economy and Profit Allocation: The Application of the Profit Split Method to the Value Created by a "Significant Digital Presence",* 26 Intl. Transfer Pricing J. 1 (2018), Journals IBFD.

[107] Despite being the preferred methodology by the EU the Member-States may still choose an alternative internationally accepted ALP method, see Article 5 para. 6.

[108] See **EUROPEAN COMMISSION**, *Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence,* p. 8.

[109] See *ibidem* Article 5, paragraphs 3 and 4. Also, see **LISA SPINOSA**, *'A Long-Term Solution for Taxing Digitalised Business Models: Should the Permanent Establishment Definition Be Modified to Resolve the Issue or Should the Focus Be on a Shared Taxing Rights Mechanism?'*, 2018, 46, Intertax, Issue 6, p. 491-492 *"In other words, functions, assets and risks that relate to data or users in the market State shall be attributed to such a digital PE even if all these activities are performed at the level of the head office."*

include *(i)* expenses incurred for research, development and marketing[110], *(ii)* the number of users and *(iii)* the data collected per Member-State.

The new Digital PE clause would coexist with the current PE threshold in tax treaties and domestic rules. Article 4 from the proposed Directive dictates on para. 2 that it "*shall be in addition to, and shall not affect or limit the application of, any other test under Union or national law for determining the existence of a permanent establishment in a Member State for the purposes of corporate tax, whether specifically in relation to the supply of digital services or otherwise"*. This way the possibility of distortions and exploitation of loopholes in qualifications would be limited within the internal market.

Having looking deeply into the three models and its characteristics, the next Chapter of this thesis will be dedicated to presenting the main drawbacks of the proposals.

[110] Attributable to the significant digital presence vis-à-vis the expenses attributable to the head office and/or any other significant digital presence in another Member State.

III. CHAPTER THREE: A CRITICAL AND CONSTRUCTIVE VIEW OF THE PROPOSED MODELS

1. Critical Deficiencies and Challenges of the New Taxing Right (Pillar One)

1.1. General remarks

Since the public consultation of the Report on Pillar One Blueprint, plenty of authors have given their contribute to better understand and dissect the arguments behind the document and its philosophy[111]. Naturally, despite the efforts, Pillar One Blueprint present concerns, if applied as it is, to the current tax system (for example regarding the role of transfer pricing to profit's allocation) and remains somewhat unclear in terms of the concepts created for this purpose. In this chapter we will demonstrate what we think are the biggest problems with the OECD's Pillar One Blueprint.

[111] See, **LORRAINE EDEN**, *Winners and Losers: the OECD's Economic Impact Assessment of Pillar One*, Tax Management International Journal (TMIJ), 49(12), p. 597-609. Reproduced with permission from Bloomberg Tax (11 December 2020). Copyright 2020 by The Bureau of National Affairs, Inc. (800-372-1033)., Available at SSRN: https://ssrn.com/abstract=3743059, accessed at 04/05/2021, **AITOR NAVARRO**, T*he Allocation of Taxing Rights under Pillar One of the OECD Proposal* (March 31, 2021). OUP Handbook of International Tax Law (F. Haase, G. Kofler eds., Oxford University Press 2021 Forthcoming), Available at SSRN: https://ssrn.com/abstract=3825612 or http://dx.doi.org/10.2139/ssrn.3825612, accessed at 04/05/2021, 7, **ANA PAULA DOURADO**, *'Editorial: The OECD Report on Pillar One Blueprint and Article 12B in the UN Report'*, (2021), 49, Intertax, Issue 1, pp. 3-4, **H. VAN DEN HURK**, *OECD's Pillar One and the Return of the Pencil!*, Kluwer Intl. Tax Blog (22 Feb. 2021), 22, **LEOPOLDO PARADA**, *The Unified Approach Under Pillar 1: An Early Analysis*, Tax Notes International, Vol. 96 No. 11, Available at SSRN: https://ssrn.com/abstract=3522027, accessed at 04/05/2021, 24, **LORRAINE EDEN AND, OLIVER TREIDLER**, *Insight: Taxing the Digital Economy - Pillar One Is Not BEPS 2 (Parts I and II),* Forthcoming in Tax Management International Journal (Nov. 2019). Part I published in Tax Notes Daily (Nov 8, 2019); Part II in Tax Notes Daily (Nov 12, 2019), Available at SSRN: https://ssrn.com/abstract=3483909, accessed 04/05/2021, **V. CHAND, A. TURINA & L. BALLIVET**, *Profit Allocation within MNEs in Light of the Ongoing Digital Debate on Pillar I – A "2020 Compromise"?: From Using A Facts and Circumstances Analysis or Allocation Keys to Predetermined Allocation Approaches*, 12 World Tax J. (2020), Journal Articles & Opinion Pieces IBFD, 31. **M.D. ASTUTI**, *Three Approaches to Taxing Income from the Digital Economy – Which Is the Best for Developing Countries?,* 74 Bull. Intl. Taxn. 12 (2020), Journal Articles & Opinion Pieces IBFD (accessed 27 May 2021), 44, **THOMAS EISGRUBER, STEFAN GREIL**, *'Policy Note: Taxing the Digital Economy: A Case Study on the Unified Approach',* (2021), 49, Intertax, Issue 1, pp. 53-70.

1.2. Pressure for Widespread Consensus

One of the OECD's main challenges is no doubt uniting the member countries' opinions and political visions on applying the new taxing right under the terms set forth, in order to reach the desirable consensus-based solution. The Pillar One Blueprint definitely creates an ambitious and ground-breaking taxing rule that would only really have its intended effects if undertaken by the majority of members under the same conditions[112].

The formulary approach of Amount A will require member countries to have very similar accounting principles to determine MNEs groups profits and that may be very difficult to accomplish. On the other hand, rules regarding double taxation relief and double counting if not equally applied by member countries could also result in unwanted inefficiencies and obstacles to Pillar One. Nonetheless, from our point of view, the depth and complexity of the Report is way too much to obtain general agreement, even on fundamental topics.

On a positive note, being a proposal that intrinsically depends a great deal on consensus from a variety of member countries, the fact that the US recently stated, under Biden's administration, that it would support the OECD's proposal, indeed strengthens the political aspect of Pillar One and Two Blueprints[113], as it is a determining country to move forward with the proposal. Even though the US made the approval, the country is very scrupulous of the OECD's work because there is a fine line between taxing fully digital multinational enterprises and targeting US big tech giants, such as Facebook, Amazon, or Google. Besides this, the administration also advocates for greater simplification, reducing compliance costs, clarifying the ADS and CFB definitions, eliminating fragmentation through a comprehensive scope (i.e., eliminating the ring-fence of the digital economy and simply tax all high profit MNE groups) and pushing forward

[112] Can be quite noticeable when reading the Cover Statement of the OECD/G20 Inclusive Framework on BEPS on the Reports on the Blueprints of Pillar One and Pillar Two.

[113] In Biden's administration, Secretary Yellen announced on February 2021 that the US will engage to address both Pillars of the OECD project and that the United States are no longer advocating for 'safe harbour' implementation of Pillar 1, according to a US Treasury official and Reuter: https://www.reuters.com/article/us-g20-usa-oecd/u-s-drops-safe-harbor-demand-raising-hopes-for-global-tax-deal-idUSKBN2AQ2E6 (accessed 11/05/2021).

with tax certainty mechanisms[114]. The binding arbitration for dispute resolution seems to be a key point for the US to continue backing the OECD's Pillar One – however not many countries, specially developing countries, see binding arbitration as a viable mechanism because they see it as a "violation of their sovereignty"115.

Nevertheless, requiring such widespread consensus is a great political endeavour and may curtail the main interest of the Pillars to impose a fairer taxation, in the sense that the biggest and most powerful countries will have stronger negotiating power than developing countries, the ones who would benefit the most from the collection of Amount A. For instance, regarding the reallocation percentage of the residual profit attributed to a market jurisdiction: the agreement upon the fixed percentage will be completely arbitrary with no particular rationale[116], therefore a country with a stronger negotiation power could pressure the OECD to fix this percentage at a lower rate so that developing countries do not have a "big piece of the pie". Moreover, the same would apply to the definition of "allocation keys" used to distribute the tax base between jurisdictions – some countries might be interested in setting the bar up high in terms of eligibility to allocate the tax base, given that the allocation key will be based on local vs. total revenue. Overall, these countries with leveraged negotiating power might already be a source state of the MNE groups (with a PE or subsidiary, for instance) or even residence states (in the case of the US), whereby tax revenue is already collected otherwise, or the specific interest of the country do not converge into adopting this new system (particularly where the US is concerned).

Questions may also be raised regarding the very general definitions used in Pillar One, as to which entities and activities are in-scope of Amount A (ADS and CFB) and what economic thresholds are to be accepted in order to be eligible to Amount A(global revenue limits, safe harbour rules, profitability ratios, etc.)[117]. When analysing the Report

---

[114] See leaked document of the US Department of Treasury slide presentation in the Inclusive Framework member's meeting on April 8th at https://mnetax.com/wp-content/uploads/2021/04/US-slides-for-Inclusive-Framework-meeting-of-4-8-21-2.pdf (accessed 11/05/2021).

[115] See **H. VAN DEN HURK**, *OECD's Pillar One and the Return of the Pencil!* , Kluwer Intl. Tax Blog (22 Feb. 2021), available at http://kluwertaxblog.com/2021/02/22/oecds-pillar-one-and-the-return-of-the-pencil/ (accessed 21 Apr. 2021).

[116] See OECD, supra n. 45, p. 124: "

[117] See **ANA PAULA DOURADO**, *'Editorial: The OECD Report on Pillar One Blueprint and Article 12B in the UN Report*', (2021), 49, Intertax, Issue 1, pp. 3-4, the author suggest that hardly any 'technical work' may be developed without the relevant consensus over scoping activities: "*In spite of the hesitation on the scope, proposals reveal that taxation in the market state of both the CFB and (any other) ADS (excluding*

the reference to the "consensus" or "agreement" is more often than not and this indicates, in our opinion, that the proposal is perhaps more ambitious than it should be. Policy makers in the OECD may be more focused on achieving a political goal or a making the Pillar One a steppingstone towards international tax harmonisation than on its efficiency and feasibility, as well as successful implementation in member countries. As **YARIV BRAUNER** points out, the OECD's inclusive framework "*does not assert that such an agreement could not be reached, but rather that even if such an agreement based on the 'Pillars' framework will be reached, it would be weak and undesirable. One cannot overlook the preference of the OECD for 'a' solution, whatever it would be so long as 'an' agreement could be presented in the media and to the politicians, rather than a sustainable agreement, which core would be understood and coherently implemented by all stakeholders*"[118]. This is a true and interesting argument which we agree with: it seems that the Pillar One proposes a highly complex taxing right to which major agreement would be required in order to be achieved and, in the end, its efficiency and 'sustainability' could be underwhelming. In other words, consensus-based solutions do not necessarily mean complex outcomes. Overall, it is not about the ability of the OECD to solve and (almost miraculously) redesign the international tax problem of digital companies not paying their fair share of tax, but about ensuring that companies' profits are taxed where they are generated.

We may go further and say that connected with absence of an agreement is the discrepancy and unpredictability of policies taken by the OECD in comparison to the United Nations (hereafter, UN) for example[119]. While the OECD attempts to create a new taxing right overlapping the current international tax system and which will require vast political approvement from member countries, the UN Tax Committee has already drafted and approved a proposal for a new article (12B) to incorporate its convention

---

some sectors) will imply taxation on gross income. These proposals are possibly an inevitable result of the lack of policy consensus on key issues including the scope of the new taxing rights that are attributable to the market state. Having this in mind, it is more than questionable that technical work can be successfully performed."

[118] See **YARIV BRAUNER**, *'Lost in Construction: What Is the Direction of the Work on the Taxation of the Digital Economy?',* (2020), 48, Intertax, Issue 3, p. 271.

[119] *Ibidem*, p. 3. See also **LORRAINE EDEN, OLIVER TREIDLER**, *Insight: Taxing the Digital Economy - Pillar One Is Not BEPS 2 (Parts I and II)*, Forthcoming in Tax Management International Journal (Nov. 2019). Part I published in Tax Notes Daily (Nov 8, 2019); Part II in Tax Notes Daily (Nov 12, 2019), Available at SSRN: https://ssrn.com/abstract=3483909, accessed 04/05/2021, pp. 1-7.

model whereby a contracting state may tax income generated from the provision of automated digital services of a non-resident company in that same contracting state[120-121].

1.3. Ring-Fencing the Digital Enterprises

Before the Report on Pillar One (and Two) Blueprint was published, around 2018, the discussion amongst institutions (OECD) and academic literatures was regarding the issue of ring-fencing the digital economy for tax purposes[122]. Those in favour argued that business models eligible as "highly digital" operating in a separate market (digital economy) should be subject to a special tax. Contrarily to this idea was the notion that ring-fencing the digital economy would be virtually impossible and unfair, therefore current international tax rules would need to be amended to integrate e-commerce and attribute taxing rights to market states.

---

[120] See the 21st session of the UN Tax Committee at **UN**, Committee of Experts on International Cooperation in Tax Matters, Report on the twenty-first session (virtual session, 20–29 October 2020), E/2021/45/Add.1-E/C.18/2020/4, available at https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2021-03/English.pdf, accessed at 12/05/2021, at par. 101 et seq.
Also see document with the initial proposal: **UN**, Committee of Experts on International Cooperation in Tax Matters, *Tax Consequences of the Digitalised Economy – Issues of Relevance for Developing Countries*, E/C.18/2020/CRP.41, 10/10/2021, available at https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-10/CRP41_Digitalization%2010102020A_0.pdf, accessed at 12/05/2021.

[121] For an interesting analogy between the OECD and UN proposals, and their respective "price paid", see **H. VAN DEN HURK**, *OECD's Pillar One and the Return of the Pencil!*,…, *"While NASA ultimately managed to develop a ballpoint pen suitable for all circumstances for a hefty price tag, the OECD is unable to develop a system for all countries. And where Russia chose to work with a pencil and thereby achieve the same as NASA, a group of countries from the United Nations has managed to come up with an alternative to Pillar One that has a considerably greater chance of success."*

[122] See **A. BÁEZ MORENO**, *A Note on Some Radical Alternatives to the Existing International Corporate Tax and Their Implications for the Digital(ised) Economy*, 46(6/7) Intertax 560–564 (2018); **Y. BRAUNER**, *Taxing the Digital Economy Post-BEPS, Seriously*, 46(6/7) Intertax 462–465 (2018); **M. F. DE WILDE**, *Comparing Tax Policy Responses for the Digitalizing Economy: Fold or All-in*, 46(6/7) Intertax 466–475 (2018); **M. P. DEVEREUX & J. VELLA**, *Debate: Implications of Digitalization for International Corporate Tax Reform*, 46(6/7) Intertax 550–559 (2018); **A. P. DOURADO**, *Debate: Digital Taxation Opens the Pandora Box: The OECD Interim Report and the European Commission Proposals*, 46(6/7) Intertax 565–572 (2018), and, by the same author, *'The OECD Unified Approach and the New International Tax System: A Half-Way Solution'*, (2020), 48, Intertax, Issue 1, pp. 3-8, **L. SPINOSA & V. CHAND**, *A Long-Term Solution for Taxing Digitalised Business Models: Should the Permanent Establishment Definition Be Modified to Resolve the Issue or Should the Focus Be on a Shared Taxing Rights Mechanism?*, 46(6/7) Intertax 476–494 (2018); **A. TURINA**, *Which 'Source Taxation' for the Digital Economy?* 46(6/7) Intertax 495–519 (2018).

Consensus was never achieved and when the OECD Unified Approach was published[123] it unveiled the hybrid solution proposed by the institution: not a pure ring-fence of the digital economy in the sense that it did not focus purely on "highly digital models" and actually referred to "consumer facing businesses" (which do not operate solely remotely and have developed client database); but, on the other hand, it proposed a new nexus (via revenue thresholds) for market jurisdictions to tax profits deriving from digital services[124].

The OECD proceeded with its development and, as we know, in October 2020 published the Report on Pillar One Blueprint, integrating the inclusive framework on BEPS.

Now, the Report on Pillar One Blueprint creates a system with the aim of effectively taxing the profits generated by digital companies, operating on the digital economy globally – either by undertaking purely automated digital services (ADS) or, on a more general form, by developing a consumer-facing business (CFB) to grow the client base of current products or services' sales.

That question is: should the international tax rules not cover *all types* of companies, whether digital or not? Would it not be more rational for the OECD to focus its endeavours on recreating the current status quo in what corporate taxation is concerned? In our opinion, the answer is yes, to both questions. There are authors as well as member countries of the OECD arguing in that sense too, proclaiming that income tax rules should be the same for digitalised and conventional-type businesses (brick-and-mortar)[125].

---

[123] **OECD**, *Secretariat Proposal for a 'Unified Approach' Under Pillar One*, Public Consultation Document 9 Oct. 2019–Nov. 2019 (OECD Publishing 2019).

[124] *Ibidem,* p. 5 et seq.

[125] See **LISA SPINOSA, VIKRAM CHAND**, *'A Long-Term Solution for Taxing Digitalised Business Models: Should the Permanent Establishment Definition Be Modified to Resolve the Issue or Should the Focus Be on a Shared Taxing Rights Mechanism?*' (2018) 46 Intertax, Issue 6/7, p. 493, A selected group of States supported this idea, see **OECD**, *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, para. 391.

The process of ring-fencing digital companies from the rest of the economy, beside extremely difficult given the increasingly digitalisation of the market as a whole[126], is also undesirable in respect of fundamental tax principles such as neutrality and equality (same principles of taxation should apply to all forms of business). However, Pillar One's formula for Amount A poses multiple ring-fencing layers mainly consisting of revenue-based thresholds and a list of tailored in-scope business activities[127], despite the OECD's justification with efficiency arguments and a reduced costs-based solution standpoint.

The fact is that no differences or special features of the companies operating in the digital economy justify a different treatment for tax purposes from the "standard" companies, in particular because such "standard" companies also are using e-commerce for its benefit. Sector-based scope limitations, if any, should be principled and based only on fundamental policy mismatches or irresolvable administrability constraints.

2018, after OECD interim report main discussion* was between ring fencing the digital economy for tax purposes or setting up a new international tax system that acknowledged taxing rights to Market States: no consensus was reached.

1.4. Overly Complex

In our opinion, this is one of the Pillar One's Blueprint major concerns, highlighted even back when the Unified Approach was published: the overwhelming complexity of the proposal, from the concepts to the formula to attribute the taxing right

[126] As admitted by the OECD since 2018 until today's recent reports, see *Interim Report 2018*, p. 18: *"... it would be difficult, if not impossible, to 'ring-fence' the digital economy from the rest of the economy for tax purposes"* and **OECD**, … *Pillar One Blueprint*, p. 10. See also **UN**, Committee of Experts on International Cooperation in Tax Matters, *Tax consequences of the digitalised economy*, E/C.18/2017/CRP.22, para. 11 and 12.

[127] See. **AITOR NAVARRO**, T*he Allocation of Taxing Rights under Pillar One of the OECD Proposal*, OUP Handbook of International Tax Law (F. Haase, G. Kofler eds., Oxford University Press 2021 Forthcoming), Available at SSRN: https://ssrn.com/abstract=3825612, accessed at 04/05/2021, p. 17.

to the market jurisdiction[128]. We will start by showcasing the complexity of the economic foundation upon which the Report is drafted: the Economic Impact Assessment[129].

Firstly, we should point out that Pillar One is drafted under the foundation that international enterprises operating within the digital economy are deriving profits without attributing the "fair share" of tax to market jurisdictions. The questions are *how much* profits are these companies generating and *what* are the ratios between revenue and profits (profitability test) that they might that actually justify creating a new taxing right. The Economic Impact Assessment tries to answer these questions, amongst others. It creates an economic scenario for MNE groups operating in the Digital Economy.

Despite the very difficult task the OECD economists had to draft this document without much financial data, the numbers upon which this assessment was based could be overestimated and overlap the relation between Residence and Source jurisdictions[130]. The Economic Impact Assessment used 2016 financial data from MNEs and countries (including the first CbCR, which had its own problems[131]), when MNE were using tax-abusive structures and exploiting loopholes purely for tax avoidance purposes. This was before the BEPS reforms were implemented and legislations from OECD member

---

[128] See following literature corroborating this critic: **LORRAINE EDEN**, *Winners and Losers …,* p. 600 et seq., **AITOR NAVARRO**, T*he Allocation of Taxing Rights under Pillar One of the OECD Proposal, …*, p. 15-19, **ANA PAULA DOURADO**, *'The OECD Unified Approach and the New International Tax System: A Half-Way Solution'*, (2020), 48, Intertax, Issue 1, pp. 3-8, **VIKRAM CHAND**, *'Allocation of Taxing Rights in the Digitalised Economy: Assessment of Potential Policy Solutions and Recommendation for a Simplified Residual Profit Split Method'*, (2019), 47, Intertax, Issue 12, pp. 1035, **YARIV BRAUNER**, *'Lost in Construction: What Is the Direction of the Work on the Taxation of the Digital Economy?, …,* p. 272, **M.R. ASTUTI**, *Three Approaches…,* p.725, **PABLO MAHU MARTÍNEZ**, '*Distributive Profit Allocation Rules: A New Approach for an Old Problem'*, (2021), 49, Intertax, Issue 2, pp. 151., **G. K. SINGH, W. JOE MURPHY, & G. J. OSSI,** *The OECD's Unified Approach- An Analysis of the Revised Regime for Taxing Rights and Income Allocation,* Tax Notes Int'l (3 Feb. 2020).
And for a practical scenario demonstrating Amount A's formula complexity, see the study of **THOMAS EISGRUBER, STEFAN GREIL**, *'Policy Note: Taxing the Digital Economy: A Case Study on the Unified Approach'*, (2021), 49, Intertax, Issue 1, pp. 53-70,

[129] **OECD**, *Tax Challenges Arising from Digitalisation – Economic Impact Assessment: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. For ease of reference we will use the term "OECD Economic Impact Assessment" or "EIA" for this document.

[130] See **LORRAINE EDEN**, *Winners and Losers …,* p. 600.

[131] *Ibidem,* p. 601, for example the author points out "*The CbCR data are for one year (2016), which was the first year that CbCR reports were collected. They were therefore more likely to have flaws and inconsistencies…".*

countries was passed addressing this issue[132]. It is thus very likely that nowadays (i.e., 2020 data) reported revenues from MNE are lower and more trustworthy.

Besides using undated financial information, that likely led to overestimates, the fact that the Assessment had very little data on MNE profits, specially outside the ultimate parent's jurisdiction, (sources were CbCR and Orbis Data) required economists to extrapolate and formulate generalisations based on macroeconomic records[133]. As **L. EDEN** stresses: "*Given the absence of* micro-*level, location-specific data on MNE profit, the EIA was forced to engage in a highly complex set of calculations based on* macroeconomic *data on foreign direct investment (FDI). As EIA Annex 5.C. explains, the economists started with bilateral FDI statistics from the OECD and IMF covering 98% of bilateral FDI. Extrapolation using gravity models based on GDP and per capita GDP was used to fill in the missing 2% of observations.",* revealing the opinion that that *"hiding behind equation are dozens - maybe hundreds - of earlier choices that are not visible unless you ''unpack'' the calculations and work through them step by step. The process looks simple to the uninitiated but each step is showing only the proverbial ''tip of the iceberg''; at least 90% of the decisions are unobservable…"*[134]. These observations leads us to conclude that the Economic Impact Assessment of the OECD includes estimations on revenues and profits that have a weak financial grounds and may induce the reader into overly positive conclusions, regarding in-scope revenues generated by MNE groups on a international basis.

Another calculation that deserves a highlight is related with the users of a market jurisdiction. As per Pillar One rules, the right to tax profits allocated under Amount A would be distributed amongst eligible market jurisdictions according to an allocation key – this element is based on locally in-scope revenue. For ADS activities (i.e., online advertising) sourcing rules will deem revenue to arise in the jurisdiction where the user is located. Hence, user's location is fundamental.

Now, the Economic Impact Assessment naturally does not include (or the economists working on it did not have knowledge of) ADS destination-based sales per

[132] See **OECD/G20**, *Inclusive Framework on BEPS: Progress Report July 2019-July 2020* (OECD: 18 July 2020).
[133] See **OECD,** *Economic Impact Assessment*, p. 258 et seq. (Annex 5.C.)
[134] See **LORRAINE EDEN**, *Winners and Losers …,* p. 602 and 600, respectively.

jurisdiction. Therefore, an extrapolation was made using a formula to proxy the ADS sales, consisting of multiplying (i) the regular internet users by (ii) the average consumption per person in the jurisdiction of all goods and services in that jurisdiction by (iii) a constant across jurisdictions[135]. In other words, given that there is no information available on ADS sales across countries, the EIA assumes they can reach real levels by multiplying national levels of internet usage by per-capita consumption times a constant. In our opinion this is a very questionable formula and therefore the estimation of the ADS sales cannot be reliable, because of the obvious disparities amongst OECD countries, in terms of revenues derived from ADS activities, are not compatible with the assumption that ADS represents a constant share of the consumption basket of internet users across countries[136].

Having that said about the Economic Impact Assessment, we shall now outline the complexity aspect of the Amount A proposed in Pillar One.

The current legislation and conventions for international and domestic corporate taxation are already vast and the create a somewhat difficult task for the taxpayer to comply with this framework. Hence, creating a new taxing right is certainly not an easy task, particularly when dealing with intangible assets. However, the harder and more complex a tax is, the more difficult it is for the administration to apply and enforce it; especially considering the fact that Pillar One is intended to be applied by more than 100 members countries. But then again, the complexity of the report is related with the OECD's need to obtain overall consensus of the proposal for it to move forward.

There are four main elements of Amount A that are, in our opinion, extremely confusing and desert a highlight in this study. Further work to simplify (if even possibly) these rules is required, otherwise it will surely generate complications for both tax administrations and taxpayers:

[135] See par. 103. Regarding the third element, according to the EIA, in the same paragraph: "The third variable, which is not directly observed due to lack of comprehensive cross-country data on ADS consumption, is assumed to be constant across jurisdictions."
[136] Fact that is recognised by the EIA itself, see p. 45.

(i) The revenue-segmentation framework to determine the tax base:

According to Pillar One "*For the scope and nexus rules, taxpayers will need to separate their revenue between that attributable to CFB, ADS and out-of-scope activities."*[137]. But, on the other hand, the Amount A tax base and profit-margin are calculated on a consolidated group-level basis. So, Pillar One suggests that the consolidated profit margin of the whole group will work as a proxy for the in-scope profit margin.

Well, nowadays MNE groups incorporate many and independent businesses, from providing digital security services to selling products to consumers, with completely different business structures, costs, profit margins and so on. Therefore, using this segmentation framework, where the profit margin may be compensated or leveraged with out-of-scope group companies, will create an unequal playing field between taxpayers. And on a practical level, how will this be accounted for? The MNE groups calculate their consolidated accounts on different jurisdictions, subject to different accounting principles, and the underlying companies, in contrast, calculate their profits according to different jurisdictions as well. Applying the group profit-margin as proxy to the company-level in-source revenue sounds simpler that it probably is[138]. This also relates with the issue of calculating the profit-before-tax (PBT) with consolidated financial accounts[139].

The tax base determination will derive from consolidated financial accounts of MNE groups, in particular those of the ultimate parent entity (UPE). Considering that the enterprises have business activities in a considerable number of jurisdictions, a standard is required to guarantee accounting principles are alike. As a result, Pillar One establishes that the eligible generally accepted accounting principles (GAAP) used to prepare the financial accounts will be those that respect and produce a similar outcome of the International Financial Reporting Standards (IFRS).

---

[137] See **OECD**, ... *Pillar One, ...,* p. 105.
[138] See **A. NAVARRO**, *The Allocation of Taxing Rights under Pillar One of the OECD Proposal,...,* .p 18.
[139] See **OECD,** *Pillar One...,* .p 98 et seq.

The problem associated with complexity is that different MNE groups will have prepared consolidated financial accounts using different accounting standards (or GAAPs)[140], which creates a potential distortion between taxpayers[141].

Creating a mechanism (book-to-book adjustments) aiming at standardising the various financial accounts will not be a simple and straightforward task, because it involves adapting OECD's member countries accounting principles and rules in an already extremely technical area.

(ii) **The profit allocation rules to market jurisdictions and consequence overlap with current arm's length principle (ALP)**:

A formula will apply the tax base of the group to determine the *quantum* of Amount A and its distribution along market jurisdictions where an allocation key exists[142]. Furthermore, Pillar One states that this formula is not built under arm's length principle applicable to intercompany operations and respective profit allocation rules (transfer pricing)[143]. At the same time, we may read that the "allocation percentage" of residual profits must ensure that profits unrelated with Amount A continue to be taxed under existing ALP profit allocation mechanisms[144]. Hence a threshold on marketing and distribution profits ("safe harbour") is proposed to ensure that jurisdictions are still entitled to their tax revenue when a non-resident performs these activities under transfer pricing rules, but above which the same profits will be deemed of Amount A. The combination is very confusing and leads us to conclude that the OECD cannot admit the ALP is not appropriate anymore to tax the digital economy (because no income can be attributed to a market jurisdiction without a physical presence whereby an entity identifies

[140] See **OECD**, *Pillar One*, p. 100 and 102 where the report admits the complication derived with harmonisation rules in this regard. Also, the significant loophole to resolve is the UPE's consolidated financial accounts that are not prepared under eligible GAAP. It is yet not clear how OECD will overcome this problem.

[141] See **AITOR NAVARRO**, T*he Allocation of Taxing Rights under Pillar One of the OECD Proposal* (March 31, 2021). OUP Handbook of International Tax Law (F. Haase, G. Kofler eds., Oxford University Press 2021 Forthcoming), p. 16, specifically where the author explains the predicament of eligible and non-eligible GAAPs may have in practice: *"Eligible GAAPs are, in principle, those producing equivalent or comparable outcomes to the IFRS. Yet, other GAAPs are also to be allowed on a case-by-case basis. Thus, remarkably, the measurement of profit will vary depending on the location of the ultimate parent entity. Hence, two identical MNEs with different ultimate parent entity locations may display diverging profits"*.

[142] See above 2.3.

[143] See **OECD**, *...Pillar One,* p. 120 and 124.

[144] *Ibidem.*

the FAR elements – functions, assets, and risks), and attribute a fair share of tax to market jurisdictions[145]. The ALP itself should be adapted, reason why some authors have proposed to add to the functions, assets and risks analysis to market element[146].

The OECD's proposal should be either a full formulary apportionment with all countries having the same and adapted transfer pricing rules (multilaterally) to the new "digitalised" reality, which implies new interpretation ALP rules (FARM analysis), or nothing at all. Because if approved and in place, having a new internationally coordinated taxing right as Amount A, simultaneously with the current taxing rules (ALP with an outdated FAR analysis) working country to country (bilaterally), will generate a confusion and disaster in case one or two countries do an adjustment following an audit, a Mutual Agreement Procedure (MAP) or a court/arbitration decision[147].

(iii) **The issue of 'double counting' and respective determination of the paying entity**:

The coexistence of Amount A and existing taxing rights (i.e., domestic corporate taxation) may lead to double taxation of profits for the eligible MNE groups. Besides local tax paid for profits allocated to a certain jurisdiction, a company may be deemed as the "paying entity" within the group leading to the tax liability of Amount A. Now, if a certain MNE group has worldwide operations, with profits in every jurisdiction, and with

---

[145] See **M.D. ASTUTI**, *Three Approaches to Taxing Income from the Digital Economy – Which Is the Best for Developing Countries?*, 74 Bull. Intl. Taxn. 12 (2020), Journal Articles & Opinion Pieces IBFD (accessed 27 May 2021), pp. 721-728.

[146] See **LISA SPINOSA, VIKRAM CHAND**, *'A Long-Term Solution for Taxing Digitalised Business Models: Should the Permanent Establishment Definition Be Modified to Resolve the Issue or Should the Focus Be on a Shared Taxing Rights Mechanism?*' (2018) 46 Intertax, Issue 6/7, p. 493, *"This approach takes into consideration demand side factors (such as the market in which sales are made). For instance, the new nexus could be attributed a certain percentage of profits derived from sales into the market jurisdiction."*

[147] Critics such as these were already made when the *Unified Approach* document was published by the OECD, see *ibidem,* **ANA PAULA DOURADO**, *'The OECD Unified Approach and the New International Tax System: A Half-Way Solution'*,..., p. 7: "*Allocating a portion of the deemed residual profit to the Market State – or a half formula based solution – is an acknowledgement of the failure of net income tax (taxation of real income) in the international setting and an acknowledgment of the insufficiencies of arm's length for a fair attribution of income to Market States.",* and **T. EISGRUBER, S. GREIL,** *'Policy Note: Taxing the Digital Economy: A Case Study on the Unified Approach'*, p. 54: *"The integration of a bilateral but multilaterally coordinated approach in the form of the ALP with that of a multilateral procedure has considerable practical and procedural implications for both approaches."*, concluding at p. 67 that *"An increasing complexity with a burgeoning potential for disputes is inevitable, and the new Amount A system also contributes to this. The complexity is multiplied if there is an attempt to link the Amount A system with the existing system and allow them to interact."*.

potential "paying entities" in every single jurisdiction, this system to eliminate double taxation will be extremely complex and a compliance headache for the taxpayer and administrations. The Amount A is drafted under the idea of a rather centralised business model (hence the consolidated tax base method), however in the digital economy we would argue that decentralised models are more common[148].

(iv) **The losses carry-forward regime**:

The Pillar One foresees loss carry-forward rules, enabling MNE groups to offset profits with losses (or a profit shortfall[149]) incurred in previous taxable years[150]. Similarly to the double counting issues, and because Amount A has its own tax base, this system of losses will be coexisting with existing taxing rights of marker jurisdictions. As the Report explains "*This means that losses generated at entity level under the ALP-based profit allocation system ("entity-level losses") would not alter the Amount A tax base, nor would Amount A unrelieved losses affect the separate tax base of an MNE group entity determined in accordance with the ALP."*. Predictably this overlap of rules, besides increasing compliance costs, will contribute to a more complicated regime, creating a web of rules for taxpayers: domestic, bilateral (conventions), international and now multilateral (Amount A). Also contributing to the overly complex framework will be special rules for restructuring and reorganisation of MNE groups as well as reorganisation of segments, as pointed out by member countries.

Transactional regime will be necessary are presumably intricate, considering that losses incurred before Amount A was in force should be accounted for.

[148] See **OECD**, ... *Pillar One…,* p. 128 for the suggestion of some inclusive framework members to change the approach on the double counting mechanism, as it is too complex.

[149] This concept means the profits of the MNE group in a given period have fallen below the agreed profitability threshold of Amount A's formula. Despite the proposal from a group of members of the Inclusive Framework, others disagree with it arguing that this rule does not convey the loss carry-forward principles that are "designed only to enable taxpayers to recoup losses reflecting costs of their earlier investments", See *ibidem,* p. 115.

[150] See **OECD**, ... *Pillar One…,* p. 111 et seq.

1.5. Burden for Tax Administrations

By introducing a new taxing right, the tax administrations of each country will have to allocate time and human resources into learning the new regulations, preparing the formal assessments for taxpayers to fill, evaluating the tax declarations submitted, processing the payments (with legal enforcement if necessary) and, finally, dispute resolution. Not all tax administrations will have the required human skills and organisation to complete the aforementioned tasks successfully and effectively, especially the developing countries – which are those who should benefit the most from the new taxing right under Amount A.

Various elements of Pillar One's proposal will inevitably burden the tax administrations[151] (for example, database analysis for threshold and activity tests, tax base assessments, carry-forward loss rules, plus auditing and reviewing costs) and when combined together it may have the capability of seriously decrease the quality of a given tax administration's work. Particularly the segmentation framework for tax base determination will require major labour from the tax administrations, whereby the profit to revenue margin of the consolidated group will act as a proxy for in-scope profit margin, meaning the administration will have to review segmented accounts of numerous in-group entities[152].

Many references are made in the Report relating to the efforts of simplifying this new system: starting with the €750 million threshold and safe-harbour exemptions (tax base)[153]. Adding to the costs for tax administration to apply Amount A itself will be the costs deriving from third main feature of Pillar One: Tax Certainty measures.

---

[151] See **J. ÁNGE & G. REQUENA**, Adapting…, p. 739: "*The greatest problems presented by this proposal involve tax administrations effectively verifying such volume of income owing to their lacking jurisdiction beyond their borders. In this regard, the exchange of tax information between administrations is of paramount importance."*

[152] As the Report well leaves explicit: "*…using segmentation to determine the relevant PBT measure will create additional compliance costs for taxpayers and extra burdens for tax administrations who will need to review these segmented accounts as part of any compliance activity and within the context of the tax certainty process.*", in **OECD**, *Pillar One*, p. 99.

[153] **OECD**, *Tax Challenges …,* p. 58, 66, 112 and 169.

According to the Pillar One, one of the essential aspects of the document is to ensure stability and reduce disputes between taxpayers and administrations[154]. The mechanism used shall be a mandatory binding dispute prevention process, based on existing framework for mutual agreement processes (MAP). As such, once the taxpayer and tax administrations agree, through a representative panel mechanism, upon key elements of Amount A (activities performed, allocation of central costs, existence of a nexus in certain jurisdictions) *"these outcomes would be binding on the MNE and tax administrations in* ***all jurisdictions*** *affected by the calculation and allocation of Amount A, including jurisdictions that did not participate directly on the relevant panel."*[155]. Besides the obvious problem with the need for a wide ranged consensus between taxpayer and *various* jurisdictions over very technical information[156], there is the challenge of certain countries obviously opposing the application of the Amount A, with the argument of tax sovereignty, when that country did not have a word on the dispute resolution agreement, as Pillar One suggest under its hierarchy-orientated representative panel. In our opinion this mandatory dispute resolution mechanism is unrealistic as it is.

Secondly, in terms of increase of costs for tax administrations, Pillar One states that mandatory binding dispute prevention process will have as foundation 1) the dispute prevention system and 2) existing regulation of MAP. Well, what if market jurisdictions, including in developing economies, have no or low levels of MAP? On the other hand, what are the costs for administrations to implement the "new and innovative" dispute prevention and resolution mechanisms, including the review panel? This panel will review the MNE group's assessment, having a lead tax administration that will need framework to decide who will be elected as the leading part (determination panel and associated costs of implementing it), will include cross-communication between the lead and other administrations (hence, the time consumption and human resources training costs), and even a newly virtual database created by the MNE groups to provide details to tax administrations[157]. So, summing up, the burden and costs of implementation are wholesome for both tax administrations and MNE groups in a surprising level. Most likely only a small group of countries will be able, as the proposal stands, to efficiently

[154] *Ibidem,* p. 168 et seq.
[155] *Ibidem,* p. 168.
[156] See supra no. 3.1.
[157] *Ibidem,* p. 180.

impose such demands in their domestic tax administrations and with the desired outcomes.

Concluding, in our opinion the proposal as it is will greatly interfere with the tax administration costs for compliance and enforcement of the new taxing right, and maybe in a way that could be disproportionate for the amount of tax collected[158].

1.6. Taxation on Gross Income

Although Pillar One intends to aim at taxing profits of MNE groups, and despite the efforts of the Economic Impact Assessment, the reality is that the formula to calculate the residual profits to reallocate to market jurisdictions (Amount A) relies heavily on proxies and presumptions, most definitely undermining the net taxation principle.

Just after the Unified Approach was published by the OECD/G20 literature raised this critic right away regarding this topic[159], including **ANA PAULA DOURADO**, point out: *"Allocating a portion of the deemed residual profit to the Market State – or a half formula based solution – is an acknowledgement of the failure of net income tax (taxation of real income) in the international setting..."*[160]. When published and after a thorough analysis the Report on Pillar One Blueprint does in fact reveal that taxing the real profits of the MNE groups on a net basis is a near-impossible task.

The Amount A sacrifices the net taxation principle off companies, at least, in the following areas: the tax base calculations (segmentation framework), the reallocation rules (allocation key) as well as losses carry-forward system (time restrictions).

To obtain the residual profits to which a reallocation percentage will apply and consequently attribute an amount to eligible market jurisdictions a formula shall be used,

---

[158] See **M.D. ASTUTI**, *Three Approaches to Taxing Income from the Digital Economy – Which Is the Best for Developing Countries?*, …, p. 725.

[159] See, amongst others, **S. BURIAK**, *'A New Taxing Right for the Market Jurisdiction: Where Are the Limits?*', (2020), 48, Intertax, Issue 3, pp. 301-316. For a more general study see **A. BAÉZ MORENO & Y. BRAUNER**, *Withholding Taxes in the Service of BEPS Action 1: Address the Tax Challenges of the Digital Economy*, p. 4 (2015), White Papers IBFD;

[160] See from the author *'The OECD Unified Approach and the New International Tax System: A Half-Way Solution'*, (2020), 48, Intertax, Issue 1, pp. 3-8

a particularly complex formula. The base for this calculation are the group's consolidate accounts, prepared under generally accepted accounting principles (GAAP). Segmentation will be deemed necessary when taxpayers cannot figure the exact net profit related with each activity (ADS, CFB or out-of-scope), which is determined through a series of tests, or "segmentation hallmarks"[161]. In practice, most MNE groups will be subject to this framework safe that various digital activities are perform within group-entities, some in-scope others out-of-scope.

Because it is difficult to locate costs in these digitally based business models, the Pillar One proposes, via a rather intricate set of rules (and presumptions), to apportion costs between the group's segments depending on the key factor of revenue. Despite the fact of being a rebuttable presumption[162], this is clearly an indirect method to calculate the tax base, creating a fictional percentage of costs based on geographical and turnover basis to be applicable to other segments of the MNE group. This is a departure from the principle of net taxation, which implies that taxpayers have the liberty of declaring economically relevant costs incurred in order to perform their business activity. The model proposed in Pillar One is distorted and complicated, with potential harm to distortion effects to economic agents[163].

Secondly, as explained above[164], Pillar One suggests a formulaic approach by using the profit margin of the whole group's activity (consolidated accounts revenue-to-profit ratio), including therefore in-scope and out-of-scope revenue, as a proxy to calculate the in-scope profit, i.e. applying the same ratio to in-scope revenues[165]. Hence,

---

[161] This particular issue could be developed further because of privacy related rights: taxpayers will have to disclose operating segment (IFRS 8 – requires particular classes of entities to disclose information about their operating segments, products and services, the geographical areas in which they operate, and their major customers) in their financial statements to prove the segmentation hallmarks are verified. Otherwise, i.e. if a taxpayer does not disclose any operating segments, a presumption of Amount A calculation on a group basis will be applied.

[162] The creation of a safeguard rule in this matter is also thought of whereby the revenue-based cost allocation would not be triggered automatically, yet again increasing the complexity of the system and compliance costs.

[163] We agree with following opinion and find relevance on referring it, see **MAARTEN F. DE WILDE**, *'Comparing Tax Policy Responses for the Digitalizing Economy: Fold or All-in'*, (2018), 46, Intertax, Issue 6, pp. 471: "*I would nevertheless argue for taxing on a net basis rather than for taxing turnover (i.e. on a gross basis). Gross turnover-based taxes can easily transform profitable pre-tax returns into post-tax losses, particularly when business is large-scale and low-margin, as is often the case with e-tailers, and hence distort an efficient operation of markets."*

[164] See 2.2.

[165] See **OECD**, *Pillar One*, p. 99 and 105 et seq.

the group level profit margin will not necessarily resemble the in-scope profits, being a fictional hypothesis (the proxy), which again is a divergence from the net taxation principle.

After the tax base is calculated under the formula described, the 'residual profits' shall be apportioned between the eligible market jurisdictions, having as point of reference the allocation key. The allocation keys will thus define the amount of share market jurisdictions are entitled to. Our critic is that, besides the taxable income definition rules relying on a gross income basis (in-scope revenue), also the reallocation of profits seems to stick with the same element as orientation[166]. The taxing right (profit allocation) of a given jurisdiction should arise from the connection between the MNE and the wealth creation in a particular area – and considering the special circumstances of the digital economy, this wealth does not necessarily occur where revenue is collected, rather being where user data and customer involvement contribute to the production process[167].

It may also be argued that there is lack of consensus over which allocation rules are the most appropriate and effective, hence no technical work can be done to overcome this situation[168].

Finally, the net taxation principle is arguably also in jeopardy regarding the losses carry-forward system, specifically in what time restrictions are concerned. The consideration of losses is crucial to make sure the taxation of residual profits respects a net basis and prevents distortions. However, besides its complexity described above, some Inclusive Framework members admit imposing time restrictions of this mechanism

---

[166] *Ibidem,* p. 125.

[167] See **R. Petruzzi & S. Buriak**, *Addressing the Tax Challenges of the Digitalization of the Economy: A Possible Answer in the Proper Application of the Transfer Pricing Rules?*, 72(4a) Bull. Int'l Tax'n (2018), pp. 312-313. The authors highlight that revenue-based nexus is a inappropriate link to market jurisdictions and if implemented may create an unfair situation where countries where revenues are generated and countries where users contribution is receive the same residual profit allocation: *"the revenue sales threshold will link the MNE with every state where sales are made on an equal footing and not only to the jurisdiction where users contributing to the wealth production are located. In combination with formulary apportionment of Amount A under the Unified approach, the allocation of profits will not lead to a fair outcome since two different states, where in the first users actively contribute to the wealth production process and in the second they only passively consume the products produced in the first one, will get the same taxing rights and the same amount of profits attributed.",* at page 313.

[168] , **Ana Paula Dourado**, *'Editorial: The OECD Report on Pillar One Blueprint and Article 12B in the UN Report'*, (2021), 49, Intertax, Issue 1, p. 4. And **OECD**, *Pillar One,* p. 126: *"523.The existing gaps between Inclusive Framework members on this policy issue will need to be resolved as part of the discussion of the quantum of Amount A."*

in name of administrability and avoiding tax planning strategies, while others are oppose and support unlimited carry-forward, defending the net profit taxation[169].

1.7. 'Double Counting' Issue

As described previously[170], the current income tax rules of will coexist the new taxing right, inevitably causing interfaces between two independent systems in market jurisdictions, for the reason that both target corporate profits. Moreover, the issue of double counting implies that these interactions of existing ALP-based profit allocation rules and Amount A may well result in doble taxation for MNE groups in a particular jurisdiction[171].

Associated with the complexity of the Pillar One[172], this issue of double counting is to be addressed mainly through a mechanism to avoid double taxation, by alternative mechanisms: 1) marketing and distribution profits safe harbour and 2) domestic business exemption, although the Report explains that further technical work is in need in this regard[173].

While currently double taxation of income is most commonly resolved between two countries under conventional terms, the double counting issue derived from Pillar One would require a challenging multi-country cross-border agreement, assessment and execution for administrations and taxpayers[174]. Regarding the agreements and political alignment (and the inherent difficulty of achieving it), in order to fulfil the Pillar One's

---

[169] **OECD**, *Pillar One,* p. 113.

[170] See 2.4.

[171] See **OECD**, *Pillar One,*p. 121 as well as 128 et seq, See also **BLOUIN, J., L. ROBINSON** (2019), "*Double Counting Accounting: How Much Profit of Multinational Enterprises Is Really in Tax Havens?",* SSRN Electronic Journal, available at http://dx.doi.org/10.2139/ssrn.3491451 (accessed 24/05/2021).

[172] See 3.3 for our opinion. The Amount A, both in terms of taxable base and profit allocation, will have an effect on every country the MNE group has activity, forming a normative confusion web for the taxpayer with high compliance costs.

[173] See **OECD**, *Pillar One,* p. 133.

[174]Accordingly and highlighting the political endeavours inherent, see **MAARTEN F. DE WILDE**, *'On the OECD's 'Unified Approach' as Frankenstein's Monster and a Dented Shape Sorter'*, (2020), 48, Intertax, Issue 1, pp. 12-13: *"In order to achieve single taxation and prevent mismatches at a tax entity, tax base, and tax base allocation level, therefore, the countries that are affected will also have to reach agreements with each other on all of the reference points, both in policy terms and in a more legal and technical sense."*.

objective and maintaining profits' single taxation principle, the jurisdiction where the "paying entity" is deemed to be resident[175] will have to (perhaps reluctantly[176]) waive its share of Amount A so as to provide double taxation relief, under domestic rules ("netting-off" effect). Hence, for other market jurisdictions to receive their share of residual profits, the jurisdiction where the "paying entity" is located (which is arguably where a MNE group has its most profitable entity, at least in a more centralised business model) will have to waive its "piece of the pie" and apply a mechanism to eliminate double taxation of profits because of the overlay of CIT rules and Amount A rules.

This way of eliminating double taxation, however, tends to work better in a centralised business model, where a principal company owns the group's trade and marketing intangibles and realises the entire residual profit of the group while other jurisdictions perform baseline marketing and distribution functions, but is harder to assess when applied to a group with a decentralised model that leaves residual profit in multiple market jurisdictions[177]. Hence, it is argued by some member of the Inclusive Framework that because the current system pressures too much decentralised business, a new method should be adopted– leaving these rules only for centralised businesses where identifying the paying entity is easier[178].

Concluding, the issue of double counting offers great challenges, both technical and political. Mainly because of the difficulty to maintain coexisting tax systems over the same income, as well as designing multilateral consensus-dependent solutions for MNE groups performing various activities worldwide.

[175] For further explanation of this term see **OECD,** *Pillar One,* p. 138 et seq.
[176] See **MAARTEN F. DE WILDE,** supra., p. 9 and **T. EISGRUBER, S. GREIL**, *'Policy Note: Taxing the Digital Economy: A Case Study on the Unified Approach'*, (2021), *ibid,* p. 62. More radically, with the opinion that avoiding double taxation will simply not be possible under the current Pillar One ruleset, see **ANA PAULA DOURADO**, *'Editorial: The OECD Report on Pillar One Blueprint and Article 12B in the UN Report*', *ibid,* p. 4, because of the "combination of different amounts and methods" resulting in "developing countries [will] not receiv[ing] tax revenues."
[177] See **OECD,** *Pillar One,* p. 222 and 223.
[178] *Ibidem,* p. 128.

1.8. Conclusion

On a positive note, compared to other proposals, the Pillar One could potentially be one of the most effective ways of taxing the digital economy, in the essence that it could have similar outcomes to a higher number of countries, mainly because of its integration via multilateral convention – it would guarantee the desired legal harmonisation the OECD seeks. It would also submit high profitable MNE groups to tax and share it between market jurisdictions where in-scope activities are performed.

Nevertheless, considering all the critics made in this section to the Pillar One, we conclude that if its aim is to avoid proliferation of uncoordinated unilateral tax measures from countries, rather preferring a harmonised system to tax the digital economy, unfortunately the overwhelming complexity inherent to distribute residual profits under the full formulary approach presented is not going to help achieve this purpose. It also seems that the new nexus proposed is not entirely based on the right factors connected with value creation, potentially harming a fair distribution of Amount A[179], and such nexus will disrupt the existing arm's length principle guidelines in what profit allocation is concerned. Moreover, both in tax base and profit allocation grounds, the new taxing right is colliding with the existing arm's length principle[180], being confusing and doubtful as to understand if it will be compatible global formulary apportionment. If Amount A is effectively introduced and developed in the future, it may dictate the end of transfer pricing rules for profit allocation[181] – however unlikely due to the lack of political alignment to do so. Finally, with the mandatory and binding arbitration dispute resolution mechanism the proposal loses all hopes to be adopted, because developing countries will see this as a way too high of a price to pay in exchange of a (likely very low) share of profit's tax.

---

[179] **R. PETRUZZI & S. BURIAK**, *Addressing the Tax Challenges of the Digitalization of the Economy: A Possible Answer in the Proper Application of the Transfer Pricing Rules?*, *ibid,* p. 316.

[180] Some authors arguing that the ALP is capable of adapting itself and accommodate the digital economy, see **L. EDEN**, *David and the Three Goliaths: Defending the Arm's Length Principle,* Bloomberg Tax Transfer Pricing Rep. (Sept. 14, 2020), 49 Tax Mgmt. Int'l J. 493 (Oct. 9, 2020), https://bit.ly/2RsZVpJ. (accessed 27/05/2021): "

[181] See **L. EDEN, O. TREIDLER**, *Insight: Taxing the Digital Economy - Pillar One Is Not BEPS 2 (Parts I and II)*, *ibid,* p. 3: *"If introduced, Amount A could be the Trojan Horse that spells the death of the arm's-length principle and its replacement by global formulary apportionment."*

2. Necessary Improvements to a Treaty Withholding Tax for ADS

2.1. General remarks

Naturally, the UN's proposal has weakness points that may hinder its swift adoption by countries. In general we firmly believe that as opposed to a new nexus and new taxing right whereby residual profits are reallocated to specific market jurisdictions, the Digital PE model is more appropriate, simpler, and fairer to tax the digital economy – all things considered. Notwithstanding agreeing with the political and conceptual thesis, critical considerations can be made to the UN's model in particular, but also more generic opinions may be put forth as to improve this model – which we will attempt to do in this section.

2.2. Gross Basis vs. Net Taxation

The first one regards the harms of gross-basis taxation[182]. In fact, as a primary rule, article 12B imposes a withholding tax on revenues derived from ADS. It is undesirable because the taxable profits assessment and tax payment is not founded on real profits earned by the taxpayer, i.e. without consideration economically relevant costs. Moreover it may specially harm small and medium enterprises, as presumably they have lower profit margins. With an additional withholding tax these businesses will have to increase their services' prices, resulting in a negative externality towards consumers; on the other hand, this price change could lead to a loss of consumers, who shall opt for services rendered by the high profit margin businesses (MNE group) that may endure such tax cost without substantially altering their prices, further expanding their market share.

For these reasons, the UN proposes implementation of a low withholding tax on the bilateral conventions: that is 3% or 4%. This type of rate, together with the institution

[182] See **GEORG KOFLER.** *Editorial: The Future of Digital Services Taxes* (2021), EC Tax Review, Issue 2, p. 53., e **ANA PAULA DOURADO**, *'Editorial: The OECD Report on Pillar One Blueprint and Article 12B in the UN Report*'…, p. 4.

of mechanisms to avoid double taxation, aim to mitigate the dangers of gross-basis taxation.

In reality, the dichotomy between net vs. gross taxation will always be present in what the digital economy is concerned – given the fact that a particular company does not operate (by choice) physically in a jurisdiction (because there is no need to), the fact that the same company does not have significant costs to allocate specifically to that jurisdiction to be considered in assessing taxable income, the fact that this company may not have important functions, hold significant assets and assume significant risks (FAR test), the fact that the ADS income derive from intangible assets that may have been born from research and development in another country. All these contribute to the conclusion that net taxation is not plausible to obtain in *all* operating jurisdictions. A combination between the two principles is more likely to be adopted, together with the profit allocation rules – which can be further developed. The option for a net taxation is made available in this proposed model, even if for a portion of the profits, and it will be up to the taxpayers to choose between ease of compliance and tax burden. So, in our view, this model of a treaty implemented Digital PE withhold tax is the closest possible combination of efficiency and fair taxation possible.

2.3. Amount of Qualified Profits

Secondly, questions may be raised as to why the 30% is used to determine qualified profits subject to net taxation according to domestic laws of the market jurisdictions. Is this percentage not randomly picked? The profit allocation to specific countries is perhaps one of the biggest challenges of taxing the digital economy, so proposals in this regard (including Pillar One) opt for a formulary apportionment. Whilst the allocation represented in Amount A is significantly more complex[183], the UN proposal identifies 30% of the amount arrived at by applying the group's profitability ratio to the market jurisdiction. The justification is that this jurisdiction shall not be entitled to tax the entire profits and "*The figure of thirty percent is based on allocation by assigning equal*

[183] See 2.3.

weightage to assets, employees and revenue."[184]. Nevertheless, it still is a fairly random number as pointed out by critics. In fact, a company providing ADS could not have any relevant assets, employees and revenue in a particular country in order to justify a apportionment of this category. But, should this be the case, perhaps it would be economically more beneficial for the company to opt for the withholding tax over the gross amount, and subsequent elimination of double taxation in the residence country.

That being said, in our view, instead of an absolute number (30) the qualified profits should be included in the negotiation element of this model. This could be operationalised either by total discretion of the countries with predetermined limits (profit allocation from 10% to 50%, for example) or via qualitative rates based on the digital presence (for low 15%, for medium 25% and high 35%)[185]. This way contracting states could discuss and agree on how much of the eligible profits should be allocated to the market jurisdictions in question.

2.4. Conclusion

Concluding, in terms of policy making, when applying the existing conventional framework of the withholding tax to the digital economy, by expanding its scope to automated digital services, one prioritises simplicity and administrability over general adoption and legal harmonisation. An amendment to a Tax Convention is typically time consuming for governments and tax administrations, so the introduction of a new article to every convention (specially for countries with a large network of treaties) will require great endeavours. Therefore the greatest weakness of this proposal is in fact its lack of effectiveness. Compared to Pillar One, which would be implemented through broad and general expedient such as the Multilateral Instrument[186], the amendment of tax treaties

[184] See **UN**, *Article 12B Proposal*, para. 30.
[185] In practice contracting states that have low digital presence in another contracting state could negotiate the rates upon which taxpayers would be subject.
[186] *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (6 June 2017), Treaties & Models IBFD.

would still be more feasible and swifter than the approval of the Pillar One and Two under such MLI.

To compensate, the taxation of digital services based on the legal architecture already established in tax treaties and its inherent doctrine is without a doubt a straightforward method with which countries and taxpayers are used to deal with, proving greater certainty, with reduced compliance costs for taxpayers and very well administrable levels for tax authorities. Developing countries are much more protected and assured a real taxing right, as opposed to a minimal share of residual profits in which their negotiating power is greatly reduced in Amount A discussions.

3. Challenges of the Digital PE and Significant Digital Presence Test

3.1. General Remarks

The Digital PE construction, from a theoretical point of view, rightly serves its purpose in our opinion. Given today's highly digital business models and corporate structures (some purely for tax purposes only[187]), the introduction of a substantial digital presence test in the international framework would ultimately overcome the obstacle of the inexistence of physical PE in the source State, whilst preserving the cohesion and certainty of the current ruleset and principles.

Nevertheless, we must highlight the cutbacks of such construction, most importantly regarding the profit allocation rules which poses as one of the biggest challenges.

3.2. Substantial Requirements

Firstly, a digital PE is deemed to exist if elements such as number of active users, contracts concluded, or a certain amount of revenue is exceeded in a given tax period.

Between these three factors the number of contracts may not be entirely reliable because some digital platforms or services do not conclude a contract with the users or consumers, for instance the intermediation software and online marketplaces. Even between businesses (B2B), how would a tax authority in a State be able to control or supervise the number of contracts? This will pose as a major challenge, due to its digital form and number.

As for the number of users, the proposal will need to include further criteria because a user may have its origin anywhere in the world. In order to properly conclude that there is a significant digital present from a non-resident business the regulations must

[187] See **OECD**, *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, pages 79 to 82.

include other elements that show a connection with the local economy: the local domain (for example in Portugal the ".pt"), the use of official languages on the website or app, the payment options available (some countries may have specific procedures)[188].

As for the amount of revenue generated in a particular jurisdiction, we believe it a fair and reasonable criterion. Because the compliance costs associated, according to the proportionality principle, should not be is high for small and medium-sised enterprises, who would suffer greater economic consequences than the bigger enterprises. The ultimate problem will be always choosing a minimum threshold to which companies will be subject. The EU in its directive proposal alleges €7 million in digital services for a foreign company to be deem having a Digital PE. Despite being backed up by an economic impact study[189], this decision has inherently a degree of arbitrariness. On the other hand, as any type of threshold of this kind, it also raises the question as to whether a company that generates €6,999,999 of revenue providing digital services in a given country would be deemed to have digital PE. This revenue threshold may lead into further aggressive tax planning techniques employed by multinationals in order to avoid having a significant digital presence in a giver jurisdiction, by purposely allocating revenue to where it treatment is more beneficial. This threshold is to be applied in a flexible way[190] so that no distortions are provoked, which, in our opinion, lies with establishing different revenue thresholds depending on the digital services' enterprise market cap and therefore impact on a country's economy.

[188] **JOSÉ ÁNGE & GÓMEZ REQUENA**, "*Adapting the Concept of Permanent Establishment to the Context of Digital Commerce: From Fixity to Significant Digital Economic Presence*", …, pp. 737 to 739.
[189] See **EUROPEAN COMMISSION**, *Impact Assessment – Accompanying the document Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence and Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services,* Brussels, 21.3.2018 COM(2018), available at https://ec.europa.eu/taxation_customs/sites/default/files/fair_taxation_digital_economy_ia_21032018.pdf (accessed 08/06/2021).
[190] See **PASQUALE PISTONE & YARIV BRAUNER**, *Adapting Current International Taxation to New Business Models: Two Proposals for the European Union*, 71 Bull. Intl. Taxn. 12 (2017), Journal Articles & Opinion Pieces IBFD, p. 684.

3.3. Profit Allocation via Extraterritorial Tax Enforcement

The initial proposal of the digital PE suggested that the solution for allocation would be to apply the profit-slip method combined with an upfront allocation of one third of the profit to the market jurisdiction where an enterprise has no physical presence[191]. No particular reason is given for the one third (hence the occasional arbitration of choosing numbers for substantial preconditions), it is seeming as to just an element of a more formulaic approach to existing transfer pricing rules to allocate profits[192]. Similarly to the OECD/G20 proposal of Amount A (or better, an enhance and developed version) this poses as a huge challenge: countries would need to give up their sovereignty to allow one single government to assess this portion and slip it between all agreeing countries, in conformity with predetermined formulas. In our opinion it is unrealistic to believe this would work.

The EU commission in their directive proposal perhaps understood this and defended an apportionment according to ALP and the AOA[193], although with reviewed and updated elements[194]. Surely it may need development, because, *inter alia*, the significant people functions underlined in the AOA is no longer enough to capture the value created by the significant digital presence – the functional analysis inherent to the ALP has to incorporate digital interface activities (including users, their content and data) as economically relevant functions to the ownership of assets and risks[195].

In this regard, article 5 of the EU Directive proposal included the reference to the "digital interface" as well as the introduction of a DEMPE functions as the central element for the functional analysis[196]. Critics may be made to the general vagueness of the

---

[191] See **PETER HONGLER & PASQUALE PISTONE**, *Blueprints for a New PE Nexus to Tax Business Income in the Era of Digital Economy* …, pages 36.

[192] In this sense, see **LISA SPINOSA, VIKRAM CHAND**, *'A Long-Term Solution for Taxing Digitalised Business Models: Should the Permanent Establishment Definition Be Modified to Resolve the Issue or Should the Focus Be on a Shared Taxing Rights Mechanism?*',…, p. 491.

[193] See **OECD**, *Report on the attribution of profits to permanent establishments* (OECD 2010), International Organizations' Documentation IBFD

[194] See 4.3 above.

[195] See **A.S. SAMARI,** *"Digital Economy and Profit Allocation: The Application of the Profit Split Method to the Value Created by a "Significant Digital Presence",* 26 Intl. Transfer Pricing J. 1 (2018), Journals IBFD, page 5.

[196] See Article 5 (2): "*The profits attributable to or in respect of the significant digital presence (...) taking into account the functions performed, assets used and risks assumed, through a digital interface";* and (4) of the EU Directive proposal: "*In determining the attributable profits under paragraph 2, due account shall be taken of the economically significant activities performed by the significant digital presence which are*

wording used in the former (how can the digital interface, for example the registration of a user in a social media platform, directly influence the income attribution of the digital PE? Is it an asset or is the data collect the asset?)[197], and, regarding the latter, the difficulty of identifying an economically relevant intangible asset through the DEMPE functions that may be entirely attributed to the digital PE alone.

But even though it may need developments and coordination with OECD transfer pricing guidelines, the digital PE provides relatively low compliance costs for taxpayers, and we believe it prioritises the tax certainty[198], effectiveness, and fairness principles, in the sense that taxpayers can anticipate the tax consequences in advance of their transactions, the result would be closer to a real profit's taxation (net basis) and each States' tax sovereignty would not be curtailed[199].

3.4. Conclusion

The substantial digital presence test is the theory that better adapts the current tax rules to the digital economy without pulling apart the main principles and cohesion of the legal status quo.

The major challenge relates to profit allocation according to the arm's length principle, which need amendments to rightfully apportion income based on intangible factors such as the software and websites (which are significantly mobile factors), as well as user's utilisation or data collected. Due to the difficulty of this task, possibly formulaic elements will have to be introduced, such as global profitability ratios applied to local

---

relevant to the development, enhancement, maintenance, protection and exploitation of the enterprise's intangible assets."

[197] Similarly see **A.S. Samari,** *"Digital Economy and Profit Allocation: The Application of the Profit Split Method to the Value Created by a "Significant Digital Presence",…* , page 19.

[198] With predetermined formulas "*… it becomes much easier for taxpayers and tax administrations to anticipate the consequences and outcomes of taxes. Second, they also represent a practical way to enhance the efficiency of a tax system (compliance costs). In that matter, there is a link between certainty and efficiency. Improving certainty also improves efficiency.*" See **V. CHAND, A. TURINA & L. BALLIVET**, *Profit Allocation within MNEs in Light of the Ongoing Digital Debate on Pillar I – A "2020 Compromise"?: From Using A Facts and Circumstances Analysis or Allocation Keys to Predetermined Allocation Approaches*, 12 World Tax J. (2020), Journal Articles & Opinion Pieces IBFD (accessed 18 June 2021), pages 584 and 585.

[199] See **M.R. ASTUTI**, *Three Approaches*…, p. 725 and 726. And **S. BURIAK**, *'A New Taxing Right for the Market Jurisdiction: Where Are the Limits?*'…, p. 313.

market jurisdictions or predetermined percentages of profit's allocation– in line with other theories in this regard.

The second major challenge will be transferring the proposal into hard law, as a relatively wide range of agreement is required by States in this regard. Although updating all tax treaties in respect of BEPS practices may now be achievable via the multilateral instrument, perhaps the adoption of a Directive from the EU would be more realistic and efficient, because of the general guidelines provided (which eases the agreement process), further enabling Member States to develop these guidelines on their terms into their laws[200].

[200] This is a representation of the EU's proportionality principle, see **EUROPEAN COMMISSION**, *Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence*, page 5.

4. The Role of User-Based Value Creation

Historically, international tax rules were first implemented to attribute to the States where economic value was located (ie, the Source State) a right to tax, over the profits made from a non-resident operating within its territory. The allocation of taxing rights was therefore complying with the benefit principle of taxation[201]. Hence, international consensus was achieved over the idea that non-resident company's profits generated in a country would become taxable once a permanent establishment was deemed to exist therein, as this was indeed a form of engagement with the local economy and a way of generating real value[202].

For example, if a mining company with its headquarters in the United Kingdom would operate abroad in Botswana and had installed a mine for the extraction of natural resources, the latter could levy the profits attributable to this mining facility, once it is considered to be a permanent establishment of the UK company, under the terms of the Tax Treaty signed by both states.

Well, in 2021 the world is much different and significantly more advanced businesswise. The reality has evolved from mines to digital services. The purpose of a company remains the same: to generate profits to its shareholders. However, arguably the main resource of the current world's most profitable companies, or, in other words. what truly creates its economic value, is no longer tangible good (a diamond, oil, etc.).

In the past 20 years the world has experienced an enormous improvement in the internet sector, giving place to worldwide, boarderless social networks, marketplaces, and advertisement platforms. As opposed to what would have been possible just 10 years ago, today we may use the same platform to rent a house in Portugal or in Thailand. Naturally

---

[201] See **J. BECKER, J. ENGLISCH**, *'Taxing Where Value Is Created: What's 'User Involvement' Got to Do with It?*', (2019), 47, Intertax, Issue 2, pp. 162, adding to the principle of benefit the idea of accessibility by tax authorities: "*The underlying assumption was that such a regime would lead to an allocation of taxing rights in conformity with the benefit principle, while also respecting administrative concerns of effective and efficient tax collection: taxes should be paid where the business would typically avail itself to a significant degree of public infrastructure and other public goods provided by the state, and where it would at the same time be visible and accessible for tax authorities*.".

[202] See **OECD** Model Tax Convention on Income and on Capital: Commentary on Article 7 para. 11 (2017).

this effect has great advantages to people's lives, creating, in general, a better social welfare.

Transposing this reality to the economic and tax doctrine, what the macroeconomic markets are experiencing is certainly a subtle shift in the factors or elements that lead to the creation of value businesswise. And this has a direct effect on the taxation of companies because profits should ideally be assessed and subject to tax according to the geographical location where economic value is created. This is why the traditional system of allocating taxing rights is facing a tremendous challenge since it is no longer that easy to identify where the value is, let alone quantify it according to geographical standards. As the recent OECD/G20 inclusive framework on BEPS clarifies: "*Weaknesses in the current rules create opportunities for base erosion and profit shifting (BEPS), requiring bold moves by policy makers to restore confidence in the system and ensure that profits are taxed where economic activities take place and value is created*."[203]. But how may we define "value creation"?

Early on of this debate, academics have contributed to reach this definition, given the relatively vague terminology used by the OECD, that may lead to different interpretations[204]. In short, a company generates value when the revenues collected from sales of goods or services are higher than operating costs. Well, in the modern economy, we believe the value created by a digital business model is characterised by typically relying on a software (artificial intelligence) that exploits data and information collected by general users (further creating profiles based on interests and general opinions)[205] in order to generate revenues.

---

[203] See **OECD** (2020), *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p. 3.

[204] See **J. BECKER, J. ENGLISCH,** *ibidem,* p.162 and 164, and **M. HERZFELD**, *The Case Against BEPS: Lessons for Tax Coordination*, 21(1) Fla. Tax Rev. 42 (2017), page 43.

[205] See **M. OLBERT & C. SPENGEL**, *International Taxation in the Digital Economy: Challenge Accepted*?, 9(1) World Tax Journal 4 (2017), page 23, and economic studies therein. The authors conclude by stating that "*value creation (for tax purposes) could encompass any activity related to generating revenue by digitised products and services based on the quantitative concept of EVA, the location of incurred current expenses, revenue sources (markets) and the capital employed should be taken into account."*, at page 30. Also see **E.G. PASQUALE PISTONE & YARIV BRAUNER**, *Adapting Current International Taxation to New Business Models: Two Proposals for the European Union*, 71 Bull. Intl. Taxn. 12 (2017), Journal Articles & Opinion Pieces IBFD, page 683

Nowadays, through this increasingly sophistication of information technologies and computer programs, multinational enterprises may conduct a large scale of cross-border operations, with significant amounts of revenue, with practically little or no presence in the operating jurisdiction. These companies may actually have millions of clients, with legal contracts in force, without fulfilling the conventional criteria of the permanent establishment in order to attribute the source state a taxing right. According to the European Commission the value of the data markets just within the 27 Member-States in 2019 was around € 400 Billion[206], while the OECD finds that around 990 multinational enterprises groups operating in the digital services' market generate an estimated profit amount of $ 600 billion[207].

And the problem relies on the fact that MNEs have taken advantage of the loopholes of the current tax framework over the past years, resulting in practically not paying any income taxes on profits generated outside its Residence State. Hence, as pointed out by important academics years ago, "*In order to address the tax challenges of the digital economy and contribute to the goal of aligning taxation with value creation, a deeper look at the value drivers, core characteristics and new elements of digital business models is needed.*"[208].

The political institutions, like the OECD through the BEPS project, have naturally been paying attention to this phenomenon, specifically by declaring that the misalignment between taxation of profits and the place where value is created is "*the result of a new and unique feature observed in some highly digitalised business models that is not captured by the existing international tax framework: the active participation of users*

[206] See **EUROPEAN COMMISSION**, *The European Data Market Monitoring Tool,* Key Facts & Figures, First Policy Conclusions, Data Landscape and Quantified Stories D2.9 Final Study Report- Executive Summary, 2020.
[207] See **OECD**, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p. 123, and **OECD** (2020), *Tax Challenges Arising from Digitalisation – Economic Impact Assessment: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p. 35.
[208] See **M. OLBERT & C. SPENGEL**, *International Taxation in the Digital Economy: Challenge Accepted*?, 9(1) World Tax Journal 4 (2017), page 22.

through an online platform, and the value that this participation creates for the business (i.e., user-generated value)[209] *"*.

To achieve the desired 'alignment' one may not need a whole redefinition of decade year old concepts such as nexus based on source and profit allocation in line with the arm's length principle – because the primary objective is to re-establish a fair and equal taxation, for what these concepts are appropriate to accomplish[210].

As we have studied and critically evaluated, the ideal path to take should adapt the nexus and profit allocation rules in order to reflect the contemporary reality of businesses in the digital economy: indeed the user contributes to value creation of the company; it is an external element that, depending on the involvement degree, strengthens the economic currency of a particular digital service. Therefore it should be accounted for.

The digital services platforms for social media, such as Facebook, Instagram, or Twitter, are more successful the more users register and the more content they create and share between each other – because the companies themselves do not produce it. These companies mostly rely on users to grow economically, especially when it regards social network platforms collecting personal data from its users.

As the OECD points out, "*Without user participation in the platform and without user-generated content, the business as we know it would not exist, although it has to be recognised that it is the platform developed through investment in information technology (IT) and intangibles such as algorithms that attracts the users. Users contribute with several types of content and by actively expanding the network (by adding friends). This and the detailed information they provide can be used to offer targeted advertising services*."[211]. This is why supporters of the theory that value creation should influence the current tax rules state that in the digital economy "*not only the supply side of an enterprise*

---

[209] See **OECD** (2018), *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p. 171. See also **OECD**, *Inclusive Framework on BEPS*, Progress Report July 2018, June 2019, and **OECD**, *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, pages 9 et. seq.

[210] **J. BECKER, J. ENGLISCH,** *ibidem,* p.165, **S. C. MORSE**, *Value Creation: A Standard in Search of a Process*, 72(4/5) Bull. Int'l Tax'n 196, 196 (2018), and **J. HEY**, *'Taxation Where Value is Created' and the OECD/G20 Base Erosion and Profit Shifting Initiative*, 72(4/5) Bull. Int'l Tax'n, 205 (2018);

[211] OECD, *Tax Challenges Arising from Digitalisation* …, p. 53.

but also the market itself enhances the value of an enterprise"[212]. The EU Commission clearly follows this reasoning[213], stating that identifying and measuring an intangible assets' contribution to the company's economic value poses a challenge for which it "*requires new methods for attributing profit that better capture value creation in the new business models*"[214].

Naturally, the user involvement may have different degrees or intensity depending on the type of business conducted by the company and how it exploits user's data for advertisement purposes[215]. Furthermore, as we have highlighted[216], the OECD also states, in the more recent blueprint, select two business models capable of having significant and sustained interactions with customers and users in a market jurisdiction[217]:

- Automated Digital Services (ADS): digital services provided remotely with little or no local infrastructure on an automated and standardised basis to a global user base. The economic value created by users derives from their data and content contributions allied with intensive monitoring and organisation of the companies[218] (Big data).

- Consumer-Facing Businesses (CFB): businesses that generate revenue from the sale of goods and services of a type commonly sold to consumers, including traditional businesses selling indirectly through intermediaries and by franchising. Online engagement with consumers (via targeted marketing and branding) substantially improves the value of their products and increase their sales.

While the first category better relates to general users of a service or software, the second implies a consolidated clients base with which it interacts. As much as this

[212] See **PETER HONGLER & PASQUALE PISTONE**, *Blueprints for a New PE Nexus to Tax Business Income in the Era of Digital Economy,* IBFD, Working Paper (2015), page 3.
[213] Proposal of Council Directive from the European Commission on the common system of a digital services tax on revenues resulting from the provision of certain digital services, COM(2018) 148 final, p. 7 and 11 et seq.
[214] See **EUROPEAN COMMISSION**, *Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence*, …, page 2.
[215] *Ibidem,* p. 54
[216] See title 2.2.
[217]OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint…,* p. 19 et seq.
[218] Examples: online search engines (Google), social media platforms (Facebook) digital content services (Netflix) and online intermediation platforms (Amazon, eBay, Uber).

categorisation might be helpful from an interpretation point-of-view, namely for better understanding "what" to tax, it does not really contribute much to figuring out "how much" to tax, i.e., how much user involvement should influence the allocable profits to a given jurisdiction. The problem does not lie with the justification to tax using value creation, but with allocating income in that same basis. Furthermore, the OECD/G20 blueprint on Pillar One is not assertive in this regard[219], however, seems work is being focused on adapting transfer pricing rules to value creation in Actions 8-10[220].

Some authors in this regard have a strong critical view, denying that the user's contribution to the economic value of a company do not justify taxing rights to the source state as well as allocation of profits, because of the vagueness terminology[221], inapplicability to a case-by-case basis and increasing tax uncertainty when integrated traditional transfer pricing rules[222].

Slightly more optimistic than this view, even though admitting the limitations of the value creation, one might defend that it simply as an extension of the benefit theory, because "*when a country makes a contribution through public services and the legal and*

---

[219] See **CRAIG ELLIFFE**, *Justifying Source Taxation in the Digital Age,* VUWLR (Forthcoming), April 25, 2021, Available at SSRN: https://ssrn.com/abstract=3833990 (accessed 08/06/2021), at page 23: "*The OECD have created much of the confusion about the concept of value creation themselves because they have used the principle in two totally different ways. It was originally used as a core component of the BEPS 1.0 project to identify profit shifting and to bolster the transfer pricing rules, but more latterly it is also been used as a principle for the justification and allocation of taxing rights.*".

[220] See **OECD**, *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 – 2015 Final Reports*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

[221] See **CRAIG ELLIFFE**, *Justifying Source Taxation in the Digital Age, …,* p. 19: "*The second observation is that because value creation is a concept or principle it is quite vague. Value creation could be attributed to employee location, sales location, location of production capacity, location of management or the location where capital is raised".*

[222] See, for example, **ANA PAULA DOURADO**, *'Editorial: The OECD Report on Pillar One Blueprint and Article 12B in the UN Report*', …, page 3: "*Value creation is inappropriate as a principle for justifying the attribution of taxing rights to the market state, and such inadequacy goes beyond the binomial OECD countries' v. developing countries' interests. Value creation is inapplicable as a basis for attributing taxing rights to the market state from the moment the latter is thought to be different from the source state.",* **SVITLANA BURIAK***, A New Taxing Right for the Market Jurisdiction: Where Are the Limits?, (2020), 48, Intertax, Issue 3, pp. 301-316*, specially at page 316: "*The concept of value creation cannot be used as the principal justification for the allocation of taxing rights to market jurisdictions. Value creation can be relied upon when allocating profits between different units of the group to examine on a case-by-case basis what are a company's most valuable activities in terms of generating revenues. However, the value of those activities cannot be easily quantified and therefore, there is no basis in principle for arguing that customers as such create value and quantifying this value for each business model.".* See also **S. C. MORSE**, *Value Creation: A Standard in Search of a Process*, 72 (4/5), Bulletin International Taxation, pages 196 to 202 and **WOLFGANG SCHÖN**, *Ten Questions About Why and How to Tax the Digitalised Economy*, 72 Bull. Int'l Tax'n 278, 282.

economic environment which enable the creation of value for an enterprise, then the benefit theory justifies taxation."[223]. Nonetheless, the allocation of profits to a State based on this interpretation would still be unachievable.

According to this view and which we agree with, the economic justification of source taxation would be an extension or adaptation of the benefit theory, given the fact that a non-resident digital company operates in a country that provides a business environment with a free operating economy, a legal system to enforce contractual obligations, to protect IP rights and safeguard potential employers from criminal conducts, a technological and telecommunications infrastructure (including most importantly Wi-Fi and mobile data), an employee workforce, and perhaps more interestingly a country that has a number of users with devices that allow interaction with the digital platforms.

Despite this validation for establishing a nexus, the next step lies with accepting the "value creation" for attribution of income, specifically to highly digitalised businesses.

In our opinion the contribution of users[224], in number and in the level of involvement, greatly influences the real economic value of a digital services' enterprises – in a word because most of these companies generate revenue by placing adverts, that naturally have a higher cost the more users potentially see the advert[225].

However the value creation theory uses indeed very vague terminology in which not only digital users/consumers and new 'value drivers'[226] are included, but also more traditional productive elements such as employee location, management location or production facilities. These are often spread around the world in different locations, which

---

[223] See **CRAIG ELLIFFE**, *Justifying Source Taxation in the Digital Age, ...,* pages 19 and 20. The author further adds that perhaps the value creation "*seems to have a more meaningful focus in the anti-avoidance context of base erosion and profit shifting"*, because no value is created where no economic activity is performed, for instance in a tax haven.

[224] See **J. BECKER, J. ENGLISCH**, *'Taxing Where Value Is Created: What's 'User Involvement' Got to Do with It?'*, (2019), 47, Intertax, Issue 2, pages 166 to 171, where the authors advance and analyse that *"The key user contributions are thus identified as three-fold: (1) enhancing network effects, (2) facilitating data mining and (3) being engaged in digital content production."*

[225] Considering the amount of data collected and creation of profiles from big tech, these companies are able to specially target certain groups of people, further increasing the adverts price.

[226] See **R. PETRUZZI & S. BURIAK**, *Addressing the Tax Challenges of the Digitalization of the Economy: A Possible Answer in the Proper Application of the Transfer Pricing Rules?*, 72(4a) Bull. Int'l Tax'n (2018), page 11.

leads academics to conclude that it is "*it impossible – even conceptually – to pinpoint the contribution of each specific location to the overall profit earned"*[227]. Furthermore, according to this view, it would be extremely difficult to relate profits earned to the benefits provided by a given State where the company operates, because of its very limited utilisation[228].

The major cutback with applying the value creation theory into income attribution is related with the misconfiguration of transfer pricing rules, specifically the profit split method. The adaptation of these tax rules to the digital economy implies a new approach to the importance and measures of the assets, functions and risks to generate value[229] - which have already been put forward by the international tax academic community, for instance the proposal by R. PETRUZZI AND S. BURIAK, that suggest adopting a Value Chain Analysis and integrating new functions in highly digitalised models within the FAR analysis and the identification of significant people functions[230]. And as the authors say, "*there is no need to "reinvent the wheel" and create "new" forms of taxation to catch business profits on digital transactions"*[231]

Until now the FAR analysis under the Authorised OECD Approach (AOA) was sufficient to identify and attribute profits to permanent establishments[232]. But the functions performed by employees, for example, is no longer an appropriate key element for highly digitalised businesses. Nevertheless, as mentioned above, we believe there are assets, even though digital or virtual assets, that may be allocable to a digital PE in a given country, such as the websites, the physical servers, data, clouds, and so on. Surely the

---

[227] See **M. DEVEREUX AND J. VELLA**, *"Implications of Digitalisation for International Corporate Tax Reform"* (2017) Oxford University Centre for Business Taxation, page 9.
[228] See **M. DEVEREUX AND J. VELLA,** "*Value Creation as the Fundamental Principle of the International Corporate Tax System*" (2018) Oxford University Centre for Business Taxation, page 6:*"First, profit is likely to be a poor proxy for the benefit received. Highly profitable companies may make limited use of public services and resources, while loss making companies may place a very heavy burden on them."*
[229] Point 3 of this chapter. See **M. OLBERT & C. SPENGEL**, *International Taxation in the Digital Economy: Challenge Accepted*?,…, page 44 and 45, commenting regarding the tax policy adopted: "*As a pragmatic and concise policy option to meet the tax challenges of the digital economy, specific guidance on the transfer pricing of digital business models could be developed. Such an approach requires an internationally coordinated revision of the common analysis of assets, functions and risks for the digital economy to produce a global standard for value-creating factors in the digital economy.*".
[230] See **R. PETRUZZI & S. BURIAK**, *Addressing the Tax Challenges of the Digitalization of the Economy: A Possible Answer in the Proper Application of the Transfer Pricing Rules?*, pages 1 to 19, and **S. BURIAK**, *'A New Taxing Right for the Market Jurisdiction: Where Are the Limits?',* (2020), 48, Intertax, Issue 3, pp. 301-316.
[231] *Ibidem,* page 5.
[232] See **R. PETRUZZI & S. BURIAK**, *Addressing the Tax Challenges of the Digitalization of the Economy,…,* pages 8 to 10.

data collect from the users in a specific geographical region are not stored by corporations in that same place: they will go into a cloud and processed virtually. Our opinion is that the number of users, who generate the information in the first place, as well as other similar factors directly related with a real "digital interface"[233], should be measured and accounted for when allocating company's income to the digital PE[234]. To ensure a net-basis level of taxation the revenue generated related with the origin of users should be offset with necessary costs of operations[235] (collecting, storing and processing costs), however, due to the business model in questions, the costs could not be materialised in connection with that location, and would have to be calculated according to a global formulary approach.

The EU, in its significant digital presence directive, already highlighted functions performed by a highly digitalised models that are keen to fall within the definition of "digital interface", that are measurable, contributing for the sought updated and targeted transfer pricing rules, for instance: the collection, storage, processing, analysis, deployment and sale of user-level data, user-generated content, sale of online advertisement[236].

To conclude, amongst the theoretical proposals studied in the previous chapter (residual tax over profits from ADS, withholding tax over ADS and the digital PE) we believe the implementation of significant digital presence test in the international tax framework would be the most appropriate to really capture the value users give to the

---

[233] As per article 5 of the EU Directive proposal.

[234] In this view see **Y. BRAUNER & P. PISTONE**, *Some Comments on the Attribution of Profits to the Digital Permanent Establishment*, 72(4a), Bull. Int'l Tax'n (2018), pages 1 to 3, **R. PETRUZZI & S. BURIAK**, *Addressing the Tax Challenges of the Digitalization of the Economy,* pages 18 and 19. Disagreeing with this position are several authors, see more importantly **J. BECKER, J. ENGLISCH**, *'Taxing Where Value Is Created: What's 'User Involvement' Got to Do with It?'*…: "*The authors have rejected the notion that users are coproducers in a tax-relevant way. Most user involvement is actually passive (…) itself being not tax relevant"*, **J. HEY,** *'Taxation Where Value is Created' and the OECD/G20 Base Erosion and Profit Shifting Initiative*, …, pages 203 to 208, **ANA PAULA DOURADO**, *'Editorial: The OECD Report on Pillar One Blueprint and Article 12B in the UN Report*', …, page 3.

[235] For a similar opinion see **R. PETRUZZI & S. BURIAK**, *Addressing the Tax Challenges of the Digitalization of the Economy,…,* page 18 and 19: "*This attribution of profits could be based, for example, on the revenue deriving from Data that generate revenue collected from users in the PE state. However, such Data alone would not generate any value. In order to generate value, Data would have to be, inter alia, collected, elaborated and exploited. Consequently, the revenue derived from Data should be netted off against all of the costs necessary to collect, elaborate and exploit Data. Ultimately, the profits attributable to the PE would be determined subsequently"*

[236] See Article 5, paragraph 5, points (a) to (e).

company, through a graduated upfront allocation of profits to the digital PE depending on the level digital interface[237]. Therefore, should the involvement of user-based activities performed by the digital PE more profits should be proportionally allocated to it. This way user-based valuation would be feasible and consistent with OECD transfer pricing guidelines.

[237] Following in essence the proposal by **A. S. SAMARI** in *Digital Economy and Profit Allocation: The Application of the Profit Split Method to the Value Created by a "Significant Digital Presence…* at pages 20 and 21: "*According to the author, the upfront allocation of profits should be proportional to the key driver of digitalised business models mentioned by the EU legislator as one of the alternative indicators to identify a significant digital presence (…) More precisely, the author would propose the following proportional upfront allocation scheme:*

– one fifth of the enterprise's profits should be attributed to the significant digital presence if the number of users located in the significant digital presence's Member State is equal to or lower than 200,000;

– one quarter of the enterprise's profits should be attributed to the significant digital presence if the number of users located in the significant digital presence's Member State is between 200,000 and 500,000; and

– one third of the enterprise's profits should be attributed to the significant digital presence if the number of users located in the significant digital presence's Member State exceeds 500,000.

IV. CHAPTER FOUR: CONCLUDING REMARKS

The digitalisation of the economy experienced in the last decade has had a profound impact on the international tax rules in force since the 1920's. Given the nature of digital services and the dynamic of highly digitalised business models, multinational enterprises with activity spread across the world have been capable of deeply interacting with local economies without necessarily establishing a physical presence in market jurisdiction where they operate. Hence, the key factors whereby a permanent establishment is deemed to exist in a State, according to the criteria set forth on the OECD Tax Convention Model, indeed are no longer reliable to ensure a universal and abstract application to these new business models. As a consequence, States are not capable of legally levying taxes over profits originated in their domestic jurisdictions.

This dilemma has given room for academics and political institutions to study and put forth legal proposals aiming at contemplating the digital economy in the international tax framework, ensuring that all company's profits are taxed despite deriving from traditional business activities or from digital activities.

Having studied the mentioned academic and political contributions published so far, we have identified, in this thesis, essentially three main models that may be adopted at an international and harmonised level in order to change the current status quo, in what regards international taxation of the digital economy – despite all of them lacking development to guarantee a thorough model. Naturally all three propositions have advantages and disadvantages, as well as each one has an important role in formatting the future tax framework, which the author of this thesis made efforts to rightfully emphasised throughout this study.

Henceforth, the three models we have identified are: 1) the creation of a new and innovative taxing right, parallel to the existing international tax system, based on a multilateral state agreement; 2) the targeted revision of the current tax treaties, by means of contemplating a withholding tax specifically foreseen for digital services; and, lastly, 3) the conceptual adjustment of the permanent establishment's definition, in order to extend its subjective scope from a purely physical presence into a digital significant presence.

Firstly, the proposal from the OECD/G20 focuses on establishing a new tax over residual profits, alongside a global minimum tax (the Two-Pillar solution)[238], which has been able to gather, so far, the agreement of 132 member countries of the Inclusive Framework on BEPS, according to a recent Statement of the OECD[239].

The theoretical proposition of Pillar One aims towards creating a ground-breaking tax, which only very high profitable multinational enterprises (MNEs) would be liable to, contemplating worldwide in-scope activities (namely, automated digital services and consumer-faced businesses), to be levied on the MNEs residual profits, i.e., Amount A. To calculate these residual profits a rather complex profitability ratio is proposed, which is basically a formula contemplating the MNE's revenues and costs, resulting in the Amount A. Finally, because this model is centred on a multi-State coordination structure (OECD), the right to tax these international residual profits is to be distributed between the eligible market jurisdictions, similarly defined by a particularly dense formula.

More details have been recently disclosed on a statement, in which the OECD specifies that the layout of this taxing right will likely be as follows: an MNE with a global turnover over €20 billion and profitability over 10% will have to distribute between market jurisdictions 20% to 30% of these residual profits (over the 10% ratio), distribution which is based on a revenue-based 'allocation key'[240].

Conceptually, this new taxing right will completely ring-fence the digital economy and highly digitised businesses[241], creating an unequal economic market (brick-and-mortar taxation *vs*. digital companies' taxation, subject to a new tax). Its configuration, as it is today on the Report on Blueprint Pillar One, is overwhelmingly complex (given its desire to be so thorough), jeopardizing its administrability by the Public Sectors. Besides the compliance costs for in-scope MNEs, which may perfectly be inadequate to the State's benefit in terms of fiscal revenue accrued, most of the member

[238] A two-pillar approach was particularly pushed forward from the United States, on recent G20 meetings, looking to establish a 15% global minimum corporate tax rate. Naturally, the mandatory Two-Pillar approach undermines the effectiveness of the solution as major consent and increased technical difficulties will pose as obstacles.

[239] See **OECD/G20,** *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy*, 1 July 2021, OECD 2021, pages 1-5, available at https://www.oecd.org/tax/beps/ statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf (accessed 02/07/2021).

[240] *Ibidem.*

[241] Not to mention that only high profitable companies are to be subject to this tax, which then poses a political problem – as it is publicly known, most of these companies are originated in the USA, therefore it is argued that this is a "tax for American companies".

countries' Tax Administrations will likely not be able to sufficiently incorporate these rules.

In short, as we criticised in this thesis, and following the previously mentioned Statement which emphasised this conclusion, is that perhaps aiming at an outcome with such detail, to be globally and political accepted regarding a breakthrough solution to address the challenges of the digital economy is, in our opinion, unrealistic and ultimately inadequate in its actual application.

We have concluded in this study that the main weakness of this proposal is its purpose: the ambition to have full harmonisation of the tax treatment of the digital economy – wanting to gather political and legal consensus of 100 plus countries over such a complex matter. However, as we have pointed out, if what it takes to avoid propagation of unilateral tax measures from countries is this overwhelming complex, revenue-based, formulary approach of taxing residual profits, perhaps another route shall be considered – because the purpose will not be achieved in an adequate form in the long run.

On the hand, one the main aspects we stressed was the departure from the principle of net taxation, which the OECD/G20's proposal showcases. Pillar One proposes, via a rather intricate set of rules and assumptions, the jurisdiction apportionment of costs between the MNEs' various companies exclusively reliant on the key factor of revenue.

This is clearly an indirect method to calculate the tax base, creating a fictional percentage of costs based on geographical and turnover basis to be applicable to other segments of the MNE group – a departure from the principle of net taxation, which implies that taxpayers should have the liberty of declaring economically relevant costs incurred in order to perform their business activity. This characteristic of the Pillar One model further highlights that it is distorted and complicated, with potential harm to distortion effects to economic agents.

Additionally, the new nexus proposed does not integrate at all the value creation theory (i.e. online users indirectly contribute to the growth of a non-resident fully online

company operating in the local economy), harming the desired fair distribution of Amount A, in our opinion [242].

Moreover, and finally, both in tax base and profit allocation grounds, the formula of Amount A proposed strongly collides with the existing arm's length principle, leading some authors to argue it may dictate the end of transfer pricing rules for profit allocation should this model be adopted. The tax system could face a great disruption, ultimately harming taxpayers, if both Amount A and transfer pricing rules are co-existent.

The second model we identified and examined was the adaptation of existing international tax rules, namely on tax treaties, by integrating the new reality of the digital economy. The main catalyst of this theory is the proposal, by the UN, to add an article to the model tax convention to avoid double taxation which establishes that a Contracting State could impose a limited withholding tax to a non-resident, provider of automated digital services, based on the income derived therein and paid to the resident of the other Contracting State.

This proposition is characterised, amongst other aspects, by countries not partially waiving its tax sovereignty, because the rule shall be approved on a negotiation basis between countries (as any other tax treaty would).

In addition, taxpayers have a choice, at least to some extent, between gross and net income taxation of their income – which is a positive note on this model. In this regard, despite the interesting and innovative approach, one may question as to why this amount of 30% qualified profits are subject to net taxation, according to domestic laws of the market jurisdictions. In our view, instead of a pre-approved absolute number (30%), the qualified profits should be included in the negotiation element of this model. This could be operationalised either by total discretion of the countries with predetermined limits (profit allocation from 10% to 50%, for example) or via qualitative rates based on the digital presence (for low 15%, for medium 25% and high 35%)[243]. This way contracting

[242] **R. PETRUZZI & S. BURIAK**, *Addressing the Tax Challenges of the Digitalization of the Economy: A Possible Answer in the Proper Application of the Transfer Pricing Rules?*, *ibid,* p. 316.

[243] Contracting States with lower digital presence in another Contracting State could therefore negotiate the rates upon which taxpayers would be subject to.

states could discuss and agree on how much of the eligible profits should be allocated to the market jurisdictions in question.

Generally, this proposal of the article 12B of the UN is, in our opinion, noteworthy, since it suggests a straightforward solution, prevailing for simplicity, that may be followed by countries (especially developing countries), with significantly less efforts than the OECD, targeting entities providing digital services with no physical presence in a market jurisdiction. Weight is put on integration with the current international tax system instead of disrupting innovation.

As for its shortcomings, we identified essentially three: 1) the gross-basis taxation rule, which is conceptually not desirable and it may harm primarily small and medium enterprises, and 2) the specific amount of eligible profits for the net taxation option (30%), introducing a formulary apportionment with a rather arbitrary number, and lastly 3) the fact that this model will be necessarily less effective as it would require, in principle, renegotiation of tax treaties in place to add the new article.

The third and last model studied and analysed in this thesis was the Digital Permanent Establishment, that aims to redefine the traditional nexus rules established between a non-resident company in a particular jurisdiction, onto a framework that contemplates a significant digital presence test. The authors of this model, contribution developed by P. HONGLER and P. PISTONE, were motivated by the urge of reforming the PE concept, in order to integrate both conventional and digitalised businesses. And similarly to the previously mentioned proposals, the need to tackle the problem of non-resident entities being economically engaged with an economy without fulfilling the requirements of a fixed placed of business.

The significant digital presence principle, built upon a modern interpretation of the benefit theory, seeks to establish a new legal nexus, for taxing purposes, between an operating non-resident company and a market jurisdiction where it remotely operates, based on the virtual involvement and activity of both company and users. The pertinent criteria put forth so far to measure this involvement is the number of users interfacing with a digital platform (app or website), number of business contracts concluded between

the digital company and local users, and amount of digital-related revenue generated in the given country. These are the economic indicators of a significant digital presence, hence a digital PE.

Once the conditions and requirements are fulfilled by a non-resident operating digital company, the debatable matter regarding profit allocation to the Digital PE has to be addressed, essentially either by a formulary apportionment of the tax base, or by the profit slip method based of transfer pricing guidelines, safe that a slight adaptation of such rules may be required (namely the FAR test). The original proposal, later integrated in the EU commission's proposal, in this regard suggested an innovative formulaic approach, with an upfront allocation of a partial profit to the market jurisdictions, which we critically evaluated.

This is perhaps the most debatable point on all theories, especially when admitting that the significant people functions underlined in the AOA (functional analysis under ALP) is no longer enough to capture the value created by the significant digital presence (as, *inter alia,* it disregards this concept as economically relevant functions to the ownership of assets and risks). On the other, in that profit allocation is concerned, defending that a rightful apportion of income should conceptually be able to include intangible factors such as software, websites, big data and user-based value creation is in itself challenging.

In order to effectively implement this model, we stand by the reason that the appropriate legal method would be through hard law, namely multilateral instrument (Multilateral Convention or, to a smaller extent, a EU Council Directive approval). And, as we further investigated, the EU has indeed proposed a Directive following this conceptual thesis and suggesting specific numbers to ascertain the Digital PE, with which we tend to agree.

From our point of view, considering the present business models and the proposed reforms so far made known, the introduction of a *substantial digital presence* test in the international framework, or in other words an acceptance of a Digital PE, would most successfully and adequately overcome the obstacle of the inexistence of physical PE in the source State, whilst preserving the cohesion and certainty of the current ruleset and principles.

Apportionment of profits from the multinational groups providing digital services should be preferably made according to the Arm's Length Principal and the Authorised OECD Approach, although with reviewed and updated elements – namely the development, enhancement, maintenance, protection and exploitation (DEMPE) test of the enterprise's intangible assets shall be accounted for. In a general sense, although challenging (possibly the biggest of this proposal), profit allocation needs to be, at least to a certain degree, related to the value creation inherent to high user activity and other intangible assets.

Due to the difficulty of this task, possibly formulaic elements will have to be introduced, such as global profitability ratios applied to local market jurisdictions or predetermined percentages of profit's allocation – however arguable, for practical reasons, we defend a predetermined portion of tax to be paid (wither upfront or after assessment) by non-resident companies subject to the rules of a Digital PE to the relevant State where they operate.

Choosing and supporting one of the abovementioned models to tax digital enterprises is deeply affected by the position one takes over which factors create economic value to a company.

Traditionally, since the first tax treaty agreements, the existence of a permanent establishment was linked with a physical infrastructure (for example a mine to extract diamonds) because it was an immediate premise to obtain a valuable good, which could be traded for a price in the market, therefore generating profits. Hence the theory of the benefit was developed to support this principle and quantify which and how profits should be taxed. Nevertheless the current state of the economy does not only rely merely on tangible goods, nor physical presence of companies.

A new element is now quite relevant for a company's ability to generate profits and in many cases is its foundation, and that element is the digital user or consumer.

Multinational enterprises focusing on digital services and social networks have the ability nowadays to aggregate a enormous amount of users that directly impact the companies' potential of generating revenue. These highly digitalised businesses, taking advantage of an outdated international tax framework, avoid paying taxed over their

profits outside their Residence State, being that one of these loopholes originate in concentrating the value creation on a tradable good or service.

There is no doubt that the user contributes to value creation of the company and therefore the nexus and profit allocation rules should be adapted in order to integrate this contemporary element of economic value of a company. The number and different profiles of users is an external element that, depending on the involvement degree, strengthens the economic currency of a particular digital service. Therefore it should be accounted for.

The digital services platforms for social media, such as Facebook, Instagram, or Twitter, are more successful the more users register and the more content they create and share between each other. These highly digitalised companies rely mainly on users to grow economically, especially when it regards social network platforms collecting personal data from its users.

Accepting that the users add an economic value to an enterprise is arguably easy to gather general consensus amongst the scientific community, however discrepancies arise when figuring out "how much" to tax, i.e., how much user involvement should influence the allocation of profits to a given jurisdiction. The problem does not lie with the justification to tax using value creation, but with allocating income in that same basis.

In this regard, critic authors have denied that the user's contribution should justify taxing rights to the source state, as well as allocation of profits, for the reason that it a conceptually vague and superficial and only increases tax uncertainty when integrated with traditional transfer pricing rules.

On the other hand others defend that user-based value creation is purely an extension of the longstanding benefit theory - nonetheless, the allocation of profits to a State based on this interpretation would still be unachievable.

The opinion we stand for in this thesis is that the contribution of users, in number and in the level of involvement, greatly influences the real economic value of a digital services' enterprises – most of these companies generate revenue by placing adverts, which potentially have a higher market cost as more users see the adverts.

Despite the terminology's vagueness (which would need development and functional tests), the fact is that we stand for the idea that the number of users, as well as other similar factors directly related with a real "digital interface", should be measured via an independent software, and accounted for when allocating company's income to the digital PE. The allocation of the digital PE's profits should be proportionally allocated to the real involvement of the user-based activity. This way user-based valuation would be feasible and consistent with OECD transfer pricing guidelines.

To ensure a net-basis level of taxation the revenue generated related with the origin of users should be offset with necessary costs of operations (collecting, storing and processing costs).

To conclude, amongst the theoretical proposals herein studied (residual tax over profits from ADS, withholding tax over ADS and the digital PE) we believe the implementation of significant digital presence test in the international tax framework would be the most appropriate to really capture the value users give to the company, through a graduated upfront allocation of profits to the digital PE depending on the level digital interface – much similar to the EU commission's proposal. Therefore to determine the functions performed by the non-resident entity (FAR test) the digital interface related to data or users will have to include – in ways such as the DEMPE functions, i.e., development, enhancement, maintenance, protection and exploitation of the enterprise's intangible assets which shall be accounted for.

V. BIBLIOGRAPHY

1. **A.S. SAMARI,** *"Digital Economy and Profit Allocation: The Application of the Profit Split Method to the Value Created by a "Significant Digital Presence",* 26 Intl. Transfer Pricing J. 1 (2018), Journals IBFD

2. **ADOLFO MARTÍN JIMÉNEZ**, *'BEPS, the Digital(ised) Economy and the Taxation of Services and Royalties*', (2018), 46, Intertax, Issue 8, pp. 620-638,

3. **AITOR NAVARRO**, T*he Allocation of Taxing Rights under Pillar One of the OECD Proposal* (March 31, 2021). OUP Handbook of International Tax Law (F. Haase, G. Kofler eds., Oxford University Press 2021 Forthcoming), Available at SSRN: https://ssrn.com/abstract=3825612 or http://dx.doi.org/10.2139/ssrn.3825612, accessed at 04/05/2021

4. **ALESSANDRO TURINA**, *'Which 'Source Taxation' for the Digital Economy?'*, (2018), 46, Intertax, Issue 6, pp. 495-519

5. **ANA PAULA DOURADO**, *'Editorial: Is There a Light at the End of the Tunnel of the International Tax System?'*, (2018), 46, Intertax, Issue 8, pp. 607-609,

6. **ANA PAULA DOURADO**, *'Editorial: The OECD Report on Pillar One Blueprint and Article 12B in the UN Report*', (2021), 49, Intertax, Issue 1, pp. 3-4

7. **AVI-YONAH, REUVEN S. & XU, HAIYAN**, *Evaluating BEPS* (January 15, 2016). U of Michigan Public Law Research Paper No. 493, Available at SSRN: https://ssrn.com/abstract=2716125 or http://dx.doi.org/10.2139/ssrn.2716125

8. **BAÉZ MORENO & Y. BRAUNER**, *Withholding Taxes in the Service of BEPS Action 1: Address the Tax Challenges of the Digital Economy*, p. 4 (2015), White Papers IBFD;

9. **BLOUIN, J., L. ROBINSON** (2019), "*Double Counting Accounting: How Much Profit of Multinational Enterprises Is Really in Tax Havens?",* SSRN Electronic Journal, available at http://dx.doi.org/10.2139/ssrn.3491451 (accessed 24/05/2021)

10. **CHAND, A. TURINA & L. BALLIVET**, *Profit Allocation within MNEs in Light of the Ongoing Digital Debate on Pillar I – A "2020 Compromise"?: From Using A Facts and Circumstances Analysis or Allocation Keys to Predetermined Allocation Approaches*, 12 World Tax J. (2020), Journal Articles & Opinion Pieces IBFD (accessed 18 June 2021).

11. **CHRISTOPH JESCHECK,** *'Debate: Taxes on Digital Services and the Substantive Scope of Application of Tax Treaties: Pushing the Boundaries of Article 2 of the OECD Model?*', (2018), 46, Intertax, Issue 6, pp. 573-578,

12. **CRAIG ELLIFFE**, *Justifying Source Taxation in the Digital Age,* VUWLR (Forthcoming), April 25, 2021, Available at SSRN: https://ssrn.com/abstract=3833990 (accessed 08/06/2021)

13. **D. BUNN**, *Bracing for Impact*, Tax Foundation (Feb. 2020), https://taxfoundation.org/oecd-pillar-1-oecd-pillar-2-impact-preliminary-results/?utm_content=buffer1b474&utm_medium=social&utm_source=twitter.com&utm_campaign=buffer (accessed 27/05/2021).

14. **E.G. PASQUALE PISTONE & YARIV BRAUNER**, *Adapting Current International Taxation to New Business Models: Two Proposals for the European Union*, 71 Bull. Intl. Taxn. 12 (2017), Journal Articles & Opinion Pieces IBFD;

15. **ERIC C.C.M. KEMMEREN**, *Should the Taxation of the Digital Economy Really Be Different?*, (2018), 27, EC Tax Review, Issue 2, pp. 72-73,

16. European Commission, *Communication From The Commission To The European Parliament And The Council*, Brussels, 21.3.2018 COM(2018), page 3. Available through the following link:

https://ec.europa.eu/taxation_customs/sites/taxation/files/communication_fair_taxation_digital_economy_21032018_en.pdf

17. **G. K. Singh, W. Joe Murphy, & G. J. Ossi,** *The OECD's Unified Approach-An Analysis of the Revised Regime for Taxing Rights and Income Allocation,* Tax Notes Int'l (3 Feb. 2020).

18. **Georg Kofler, Julia Sinnig**, *'Equalisation Taxes and the EU's 'Digital Services Tax''*, (2019), 47, Intertax, Issue 2, pp. 176-200

19. **H. van den Hurk**, *OECD's Pillar One and the Return of the Pencil!*, Kluwer Intl. Tax Blog (22 Feb. 2021), available at http://kluwertaxblog.com/2021/02/22/oecds-pillar-one-and-the-return-of-the-pencil/ (accessed 21 Apr. 2021).

20. **Hongler, Peter and Pistone, Pasquale**, *Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy* (January 1, 2015). Available at SSRN: https://ssrn.com/abstract=2586196

21. **J. Becker, J. Englisch**, *'Taxing Where Value Is Created: What's 'User Involvement' Got to Do with It?'*, (2019), 47, Intertax, Issue 2, pp. 161-171,

22. **J. Hey,** *'Taxation Where Value is Created' and the OECD/G20 Base Erosion and Profit Shifting Initiative*, 72(4/5) Bull. Int'l Tax'n 203 (2018)

23. **José Ánge & Gómez Requena**, "*Adapting the Concept of Permanent Establishment to the Context of Digital Commerce: From Fixity to Significant Digital Economic Presence*", (2017), 45, Intertax, Issue 11, pp. 732-741

24. **L. U. Cavelti, C. Jaag & T. F. Rohner**, *Why Corporate Taxation Should Mean Source Taxation: A Response to the OECD's Actions Against Base Erosion and Profit Shifting*, 9(3), World Tax J. 352, 354 (2017).

25. **LEOPOLDO PARADA,** *The Unified Approach Under Pillar 1: An Early Analysis* (December 16, 2019). Tax Notes International, Vol. 96 No. 11, Available at SSRN: https://ssrn.com/abstract=3522027, accessed at 04/05/2021

26. **LISA SPINOSA, VIKRAM CHAND**, *'A Long-Term Solution for Taxing Digitalised Business Models: Should the Permanent Establishment Definition Be Modified to Resolve the Issue or Should the Focus Be on a Shared Taxing Rights Mechanism?*' (2018) 46 Intertax, Issue 6/7, pp. 476-479.

27. **LORRAINE EDEN, AND,OLIVER TREIDLER**, *Insight: Taxing the Digital Economy - Pillar One Is Not BEPS 2 (Parts I and II)*, Forthcoming in Tax Management International Journal (Nov. 2019). Part I published in Tax Notes Daily (Nov 8, 2019); Part II in Tax Notes Daily (Nov 12, 2019), Available at SSRN: https://ssrn.com/abstract=3483909, accessed 04/05/2021

28. **LORRAINE EDEN**, *David and the Three Goliaths: Defending the Arm's Length Principle,* Bloomberg Tax Transfer Pricing Rep. (Sept. 14, 2020), 49 Tax Mgmt. Int'l J. 493 (Oct. 9, 2020), https://bit.ly/2RsZVpJ. (accessed 27/05/2021)

29. **LORRAINE EDEN**, *Winners and Losers: the OECD's Economic Impact Assessment of Pillar One*, Tax Management International Journal (TMIJ), 49(12), p. 597-609. Reproduced with permission from Bloomberg Tax (11 December 2020). Copyright 2020 by The Bureau of National Affairs, Inc. (800-372-1033)., Available at SSRN: https://ssrn.com/abstract=3743059, accessed at 04/05/2021.

30. **M. DEVEREUX AND J. VELLA** "*Value Creation as the Fundamental Principle of the International Corporate Tax System*" (2018) Oxford University Centre for Business Taxation.

31. **M. DEVEREUX AND J. VELLA,** *"Taxing the Digitalised Economy: Targeted or System-Wide Reform?"*, (2018) 4 BTR, 387.

32. **M. HERZFELD, THE CASE AGAINST BEPS:** *Lessons for Tax Coordination, 21(1)* Fla. Tax Rev. 42 (2017)

33. **M. OLBERT & C. SPENGEL**, *International Taxation in the Digital Economy: Challenge Accepted*?, 9(1) World Tax Journal 4 (2017).

34. **M.D. ASTUTI**, *Three Approaches to Taxing Income from the Digital Economy – Which Is the Best for Developing Countries?,* 74 Bull. Intl. Taxn. 12 (2020), Journal Articles & Opinion Pieces IBFD (accessed 27 May 2021).

35. **MAARTEN F. DE WILDE**, *Comparing Tax Policy Responses for the Digitalizing Economy: Fold or All-in*, (2018), 46, Intertax, Issue 6, pp. 466-475,

36. **MAARTEN F. DE WILDE**, *'On the OECD's 'Unified Approach' as Frankenstein's Monster and a Dented Shape Sorter'*, (2020), 48, Intertax, Issue 1, pp. 9-13

37. **MICHAEL DEVEREUX & JOHN VELLA**, *Debate: Implications of Digitalization for International Corporate Tax* Reform, (2018) 46 Intertax, Issue 6/7

38. **OECD** (2020), *OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors* – October 2020, OECD, Paris. www.oecd.org/tax/oecd-secretary-general-tax-report-g20-finance-ministers-october-2020.pdf

39. **OECD** (2020), *Tax Challenges Arising from Digitalisation – Economic Impact Assessment: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/0e3cc2d4-en

40. **OECD**, *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. Available through the following link http://dx.doi.org/10.1787/9789264241046-en

41. **OECD,** *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 – 2015 Final Reports*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

42. **OECD,** *Model Tax Convention on Income and on Capital: Condensed Version 2014*, OECD Publishing, Paris

43. **OECD**, *Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors*, Saudi Arabia (OECD Publishing, Oct. 2020).

44. **OECD**, *Report on the attribution of profits to permanent establishments* (OECD 2010), International Organisations' Documentation IBFD

45. **OECD**, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, 2020, OECD Publishing, Paris, https://doi.org/10.1787/beba0634-en

46. **OECD**, *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, 2020, OECD Publishing, Paris, https://doi.org/10.1787/abb4c3d1-en

47. **OECD/G20**, *Inclusive Framework on BEPS: Progress Report July 2019-July 2020* (OECD: 18 July 2020).

48. **P. COLLIN & N. COLIN**, Task Force On Taxation Of The Digital Economy 1, 2013

49. **PABLO MAHU MARTÍNEZ**, *'Distributive Profit Allocation Rules: A New Approach for an Old Problem'*, (2021), 49, Intertax, Issue 2, pp. 144-165.

50. **PAOLO CENTORE, MARIA TERESA SUTICH**, *Taxation and Digital Economy: Europe Is Ready*, (2014), 42, Intertax, Issue 12, pp. 784-787,

51. **PATRICIA HOFMANN, NADINE RIEDEL**, *'Debate: Comment on J. Becker & J. Englisch, 'Taxing Where Value Is Created: What's "User Involvement" Got to Do with It?''*, (2019), 47, Intertax, Issue 2, pp. 172-175,

52. **PETER HONGLER & PASQUALE PISTONE**, *Blueprints for a New PE Nexus to Tax Business Income in the Era of Digital Economy,* IBFD, Working Paper (2015). Available at https://www.ibfd.org/sites/ibfd.org/files/content/WithholdingTaxesintheServiceofBEPSAction1-whitepaper.pdf

53. **R. PETRUZZI & S. BURIAK**, *Addressing the Tax Challenges of the Digitalization of the Economy: A Possible Answer in the Proper Application of the Transfer Pricing Rules?*, 72(4a) Bull. Int'l Tax'n (2018)

54. **S. C. MORSE**, *Value Creation: A Standard in Search of a Process*, 72(4/5) Bull. Int'l Tax'n 196, 196 (2018)

55. **SUNITA JOGARAJAN**, *The Conclusion and Termination of the 'First' Double Taxation Treaty*, British Tax Review, Vol. 3, 2012, U. of Melbourne Legal Studies Research Paper No. 604, available at https://ssrn.com/abstract=2154760 (accessed at 16/06/2021)

56. **SVITLANA BURIAK**, *'A New Taxing Right for the Market Jurisdiction: Where Are the Limits?',* (2020), 48, Intertax, Issue 3, pp. 301-316.

57. **THOMAS EISGRUBER, STEFAN GREIL**, *'Policy Note: Taxing the Digital Economy: A Case Study on the Unified Approach'*, (2021), 49, Intertax, Issue 1, pp. 53-70

58. United States Senate, Committee on Finance, 2018. The letter is available at the following link: https://www.finance.senate.gov/imo/media/doc/2018-10-18%20OGH%20RW%20to%20Juncker%20Tusk.pdf

59. **VIKRAM CHAND**, *'Allocation of Taxing Rights in the Digitalised Economy: Assessment of Potential Policy Solutions and Recommendation for a Simplified Residual Profit Split Method'*, (2019), 47, Intertax, Issue 12, pp. 1023-1041

60. **W. SCHÖN**, *Ten Questions About Why and How to Tax the Digitalised Economy*, 72(4/5) Bull. Int'l Tax'n 278, 280 (2018).

61. **Y. BRAUNER & P. PISTONE**, *Some Comments on the Attribution of Profits to the Digital Permanent Establishment*, 72(4a), Bull. Int'l Tax'n (2018)

62. **YARIV BRAUNER**, 'Editorial: Taxing the Digital Economy Post-BEPS, Seriously' (2018) 46 Intertax, Issue 6/7