Contemporary aspects of the taxation of digital economy: A unified approach for a fairer allocation of taxing rights and the Global Anti-Base Erosion Proposal ("GloBE") , September 2020

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I. Introductory remarks

Base erosion and profit shifting (BEPS) refers to tax planning strategies implemented by multinational enterprises that exploit gaps and mismatches in tax rules for tax avoidance purposes[2] and lead to artificial segregation between profits and activities that originated them. Developing countries' higher reliance on corporate income tax means they suffer from BEPS disproportionately. BEPS practices cost countries USD 100-240 billion in lost revenue annually. Working together within OECD/G20 Inclusive Framework on BEPS, over 135 countries and jurisdictions are collaborating on the implementation of 15 measures to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment[3].

Especially, in the area of digital economy, its specific features and characteristics enable structures that shift profits to entities that escape taxation or are taxed at only very low rates. Value creation across new and changing business models plays a vital role for taxation in the context of digitalisation and the respective tax challenges that arise[4]. These challenges include risks for highly mobile income producing factors, which still can be shifted into low-tax environments, even after the release of the BEPS Action Plan[5]. Thus,

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[2] "No or low taxation is not per se a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it. In other words, what creates tax policy concerns is that, due to gaps in the interaction of different tax systems, and in some cases because of the application of bilateral tax treaties, income from cross-border activities may go untaxed anywhere, or be only unduly lowly taxed". See William Byrnes (Texas A&M University Law), BEPS' Bait & Switch: OECD Pillar II GloBE Comments and Recommendations, Kluwer International Tax Blog, Wolters Kluwer, December 5, 2019, http://kluwertaxblog.com/2019/12/05/beps-bait-switch-oecd-pillar-ii-globe-comments-and-recommendations/?doing_wp_cron=1596608967.5873351097106933593750 (visited 5/8/2020).

[3] See https://www.oecd.org/tax/beps/about/ (visited 5/8/2020).

[4] See Chapter 2 "Digitalisation, business models and value creation" of the Interim Report in March 2018, Tax Challenges Arising from Digitalisation – Interim Report 2018, which was delivered following a mandate by G20 Finance Ministers in March 2017, the Inclusive Framework, working through its Task Force on the Digital Economy (TFDE).

[5] See OECD/G20 Base Erosion and Profit Shifting Project, Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note As approved by the Inclusive Framework on BEPS on 23

an in-depth analysis is needed, in order to reflect the deficiencies identified in the modern tax systems, in view of the rapid developments that the technological evolution has entailed and the impetuous changes caused in the economies worldwide. These economies globally appear to be more interrelated than never. Cross-border transactions are multiplying and digitalized business models tend to replace the traditional ones. As a result, in a digital age, when the allocation of taxing rights can no longer be exclusively circumscribed by reference to physical presence, a significant deviation is observed between the place of value creation and the place of taxation, which causes noteworthy challenges, from a tax perspective, including tax avoidance schemes and opportunities as well as aggressive tax planning arrangements.

II. Factual Background: Policy Note on Addressing the Tax Challenges of the Digitalisation of the Economy

In January 2019, the Inclusive Framework issued a Policy Note on Addressing the Tax Challenges of the Digitalisation of the Economy[6], within the frame of base erosion and profit shifting (BEPS) 2.0 project. Under this Policy Note, the Inclusive Framework agreed, on a without prejudice basis, to undertake work on the following two pillars, pursuant to a coordinated approach:

- Pillar One addresses the allocation of taxing rights between jurisdictions and describes proposals for new profit allocation and nexus rules based on the concepts of "significant economic presence" and the exploitation of "user participation" and "marketing intangibles" in a jurisdiction.
- Pillar Two (also referred to as the "GloBE" proposal) calls for the development of a co-ordinated set of rules to address ongoing risks from structures that allow MNEs to shift profit to jurisdictions where they are subject to no or very low taxation[7].

January 2019, http://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf (visited 5/8/2020).

[6] Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note, as approved by the Inclusive Framework on BEPS on 23 January 2019, OECD 2019, http://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf (visited 5/8/2020). See also OECD Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy of 29 May 2019 and the International Monetary Fund Policy Paper 'Corporate Taxation in the Global Economy, Policy Paper No 19/007, International Monetary Fund, 10.3.2019. Actually, it has been over a year since the OECD initiated the bold project that seeks to address the tax challenges of the digitalisation of the economy, better known as the base erosion and profit shifting (BEPS) 2.0 project. Following a public consultation in March 2019 on the initial document outlining the two-pillar concept, the BEPS 2.0 project took shape with the publication of the Programme of Work (PoW) to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy on May 31 2019. See Barbara Angus and Luis Coronado, The OECD presses on with BEPS 2.0 in today's distressed times, International Tax Review, 30 June 2020, https://www.internationaltaxreview.com/article/b1m93zd5csctf7/the-oecd-presses-on-with-beps-20-in-todays-distressed-times (visited 5/8/2020).

[7] OECD, Global Anti-Base Erosion Proposal ("GloBE") - Pillar Two, 8 November 2019 – 2 December 2019, file:///T:/Personal%20EK/2020/public-consultation-document-global-anti-base-erosion-proposal-pillar-two.pdf.pdf (visited 5/8/2020).

The Inclusive Framework issued a Public Consultation Document on 13 February 2019, which sought input from external stakeholders on the specific proposals examined under Pillar One and Pillar Two[8]. Following this public consultation document, a public consultation held in Paris on 13 and 14 March 2019, which was attended by over 400 representatives from governments, business, civil society and academia[9]. In addition, OECD issued a public consultation document on a Secretariat Proposal for a "Unified Approach" under Pillar One (9 October 2019 – 12 November 2019) as well as a public consultation document on the Global Anti-Base Erosion Proposal ("GloBE"), within the frame of Pillar Two (8 November 2019 – 2 December 2019). In January 2020, the OECD released a statement on the two-pillar approach to address the tax challenges arising from the digitalisation of the economy, announcing that the Inclusive Framework members had renewed their commitment to the BEPS 2.0 project and providing a revised pillar one PoW and an update on pillar two, which was also endorsed by the G20[10].

A. *Pillar I: the Unified Approach*

According to the public consultation document on the Secretariat Proposal for a "Unified Approach", the scope of which is not restricted only to digital business models, but goes even further, also covering consumer-facing businesses. The Secretariat's proposal for a "Unified Approach" constitutes a solution that attracts support from all members of the Inclusive Framework. It creates a new nexus mainly based upon sales and not physical presence, designed as a new self-standing treaty provision. It also creates a new profit allocation rule, going beyond the arm's length principle and departing from the separate entity principle, applicable to taxpayers within the scope, and irrespective of whether they have an in-country marketing or distribution presence (permanent establishment or separate subsidiary) or sell via unrelated distributors. At the same time, the approach largely insists on the current transfer pricing rules based on the arm's length principle, by retaining them, but complements them with formula based solutions in areas where

[8] Public Consultation Document, Addressing the Tax Challenges of the Digitalisation of the Economy, 13 February – 6 March 2019, http://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf (visited 5/8/2020). See also IMF, OECD, UN, and World Bank (2015), Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment, A Report to the G-20 Development Working Group, pp. 8-9.

[9] OECD, Global Anti-Base Erosion Proposal ("GloBE") - Pillar Two, 8 November 2019 – 2 December 2019, file:///T:/Personal%20EK/2020/public-consultation-document-global-anti-base-erosion-proposal-pillar-two.pdf.pdf (visited 5/8/2020).

[10] Barbara Angus and Luis Coronado, The OECD presses on with BEPS 2.0 in today's distressed times, International Tax Review, 30 June 2020, https://www.internationaltaxreview.com/article/b1m93zd5csctf7/the-oecd-presses-on-with-beps-20-in-todays-distressed-times (visited 5/8/2020), according to which, on June 18 2020, the OECD released a statement from the Secretary-General expressing concern about the negative implications of unilateral measures related to taxation of digital activity and describing a multilateral solution through the Inclusive Framework as the best way forward. The OECD release indicates the intention to maintain the schedule of working group meetings leading up to the planned October 2020 decision-making meeting of the Inclusive Framework. While there certainly is substantial technical and design work to still be done on both pillars, exactly how this work will progress in light of these political developments remains to be seen.

tensions in the current system are the highest[11]. Finally yet importantly, the approach aims at increased tax certainty for taxpayers and tax administrations delivered via a Three Tier profit allocation Mechanism, which comprises from:

- Amount A – a share of deemed residual profit allocated to market jurisdictions using a formulaic approach, i.e. the new taxing right;
- Amount B – a fixed remuneration for baseline marketing and distribution functions that take place in the market jurisdiction; and
- Amount C – binding and effective dispute prevention and resolution mechanisms relating to all elements of the proposal, including any additional profit where in-country functions exceed the baseline activity compensated under Amount B.

As a general remark, the proposed rules aim to grant new taxing rights to the countries where users of highly digitalised business models are located.

B. Pillar II: The GloBE

According to the public consultation document on the GloBE, the GloBE proposal consists of four component parts, which are enumerated here below:

a) an income inclusion rule that would tax the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate;
b) an undertaxed payments rule that would operate by way of a denial of a deduction or imposition of source-based taxation (including withholding tax) for a payment to a related party if that payment was not subject to tax at or above a minimum rate;
c) a switch-over rule to be introduced into tax treaties that would permit a residence jurisdiction to switch from an exemption to a credit method where the profits attributable to a permanent establishment (PE) or derived from immovable property (which is not part of a PE) are subject to an effective rate below the minimum rate; and
d) a subject to tax rule that would complement the undertaxed payment rule by subjecting a payment to withholding or other taxes at source and adjusting eligibility for treaty benefits on certain items of income where the payment is not subject to tax at a minimum rate.

These rules would be implemented by way of changes to domestic law and tax treaties and would incorporate a co-ordination or ordering rule to avoid the risk of double taxation that might otherwise arise where more than one jurisdiction sought to apply these rules to the same structure or arrangement[12]. The core concept underlying the GloBE proposal is the

[11] OECD, a public consultation document on a Secretariat Proposal for a "Unified Approach" under Pillar One (9 October 2019 – 12 November 2019).
[12] OECD, Global Anti-Base Erosion Proposal ("GloBE") - Pillar Two, 8 November 2019 – 2 December 2019, file:///T:/Personal%20EK/2020/public-consultation-document-global-anti-base-erosion-proposal-pillar-two.pdf.pdf (visited 5/8/2020).

imperative need for addressing the shortcomings of the international tax system that are exacerbated by the digitalisation of the economy.

III. European Parliament resolution on fair taxation in a digitalised and globalised economy

Furthermore, in December 2019, a motion for a European Parliament resolution on fair taxation in a digitalised and globalised economy took place, aiming at finding a consensus solution to the tax challenges arising from the digitalisation of the economy and resulting in the respective European Parliament resolution of 18 December 2019 on fair taxation in a digitalised and globalised economy.

According to the said resolution, with respect to Pillar I, the European Parliament welcomes the proposal by the OECD Secretariat to merge all three alternatives under consideration into Pillar One given that they share the following objectives:

- reallocate taxing rights in favour of the user/market jurisdiction, that goes beyond the arm's length principle ("ALP")
- envisage a new nexus rule that would not depend on a physical presence in the user/market jurisdiction,
- start from multinationals' global profits and depart from the separate entity principle,
- aim for simplicity, stabilisation of the tax system and increased tax certainty in implementation;

As regards Pillar II (the GloBE), the European Parliament, among others:

- invites the Member States to ensure that the GloBE proposal provides for the simplest framework that would not lead to the development of harmful tax schemes and recalls Parliament's demand for an EU listing of harmful tax measures;
- highlights that recourses to carve-outs and exemptions would undermine the policy intent and effectiveness of the GloBE proposal;
- recommends that all of the harmful tax practices contained in BEPS Action 5 are covered by the GloBE proposal;
- Understands that the GloBE proposal would constitute a set of defensive measures such as an income inclusion rule, a switch-over rule, an undertaxed payments rule and a subject-to-tax rule and recalls, in this regards, Parliament's legislative resolution on ATAD[13];
- considers that the calculation of tax bases, in the framework of the GloBE proposal, should be made according to agreed international principles to avoid tax base

[13] European Parliament legislative resolution of 8 June 2016 on the proposal for a Council directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ C 86, 6.3.2018, p. 176. See also 3 Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (the Anti-Tax Avoidance Directive" or "ATAD" and Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.

erosion as well as harmful competition among countries that risks undermining the effectiveness of any possible decision taken on a minimum level of taxation;

- considers that any discussion at OECD/G20 level towards a minimum tax rate should include reflections on a definition of the base associated with that rate;
- considers that any minimum rate should be set at a fair and sufficient level to discourage profit shifting and prevent damaging tax competition;
- considers that, with respect to the income inclusion rule, a minimum level of taxation should be established for each jurisdiction where the MNEs are located in order to limit the possibilities of continuing to engage in aggressive tax planning, and therefore maintain a competitive economy;

As a conclusive remark, the European Parliament calls on the Commission and the Council to prepare the legal base for incorporating the outcome of an international deal into EU law and to present a legislative proposal as soon as possible. Moreover, it invites the Council, with the support of the Commission, to evaluate the criteria of the EU list of non-cooperative jurisdictions for tax purposes once the international rules and/or the EU's newly agreed reforms have been adopted, and to assess whether an update is necessary. Apart from the above, the European Parliament calls on the Commission to explore the possibility of avoiding a legal base requiring unanimity in the Council.

IV. Technical Analysis/Assessment

The two-pillar approach described above for addressing the tax challenges arising from the digitalization of economy and commerce incorporates a holistic approach on the taxation of digital economy. It suggests rather innovative rules and groundbreaking measures and reconstructs to a certain degree the international tax framework, as it currently stands[14].

More specifically, when it comes to the Unified Approach of Pillar I, the allocation of a new taxing right to market jurisdictions through new nexus and profit allocation rules would recognise that in today's globalised and increasingly digitalised economy a range of businesses can project themselves into the daily lives of consumers (including users), interact with their consumer base and create meaningful value without a traditional physical presence in the market. These features could be said to be relevant for any business, but they are most relevant for digital centric businesses which interact remotely with users, who may or may not be their primary customers, and other consumer-facing businesses[15] and/or user-facing activities for which customer engagement and interaction, data collection and exploitation, and marketing and branding is significant, and can more easily be carried out from a remote location[16]. This would include highly digitalised

[14] Bauer, Georg and Fritz, Jil and Schanz, Deborah and Sixt, Michael, Corporate Income Tax Challenges Arising From Digitalised Business Models (March 7, 2019). Available at SSRN: https://ssrn.com/abstract=3348544 or http://dx.doi.org/10.2139/ssrn.3348544.

[15] e.g. businesses that generate revenue from supplying consumer products or providing digital services that have a consumerfacing element

[16] OECD, a public consultation document on a Secretariat Proposal for a "Unified Approach" under Pillar One (9 October 2019 – 12 November 2019).

businesses, which interact remotely with users, who may or may not be their primary customers, as well as other businesses that market their products to consumers and may use digital technology to develop a consumer base[17].

The GloBE proposal aims at ensuring that a minimum level of tax is paid where value is being created and where economic activity is taking place. It considers that the ultimate aim of the Pillar Two measures should be to address remaining BEPS issues while preventing damaging tax competition, notably by reducing pressures to grant unjustified tax incentives without any positive economic impact, on top of existing measures aimed at tackling tax evasion, aggressive tax planning and tax avoidance[18]. Last but not least, the GlobBE proposal calls on the Commission to assess and monitor the impact of this future minimum standard on a potential general statutory corporate income tax rate decrease across the EU[19].

Pillar 2, referring to the GloBE proposal constitutes a deviation from the well-established tax principle – that constituted the genesis of BEPS – which is to tax income where value is created[20] and, therefore, such as Pillar 1, represents a substantial modifiacation to the international tax architecture. Actually, the GloBE proposal is based on an effective tax rate ("ETR") test and, thus, it must include rules that stipulate the extent to which the taxpayer can mix low-tax and high-tax income within the same entity or across different entities within the same group[21]. The GloBE proposal is intended to address the remaining BEPS challenges linked to the digitalisation of the economy, but it goes even further and addresses these challenges more broadly, aiming at combatting the "rate arbitrage". Specifically, "GloBE" proposal seeks to address outstanding BEPS issues by introducing a global minimum tax and providing "jurisdictions with a right to "tax back" where other

[17] OECD, a public consultation document on a Secretariat Proposal for a "Unified Approach" under Pillar One (9 October 2019 – 12 November 2019).

[18] See also Hadzhieva, E., Impact of Digitalisation on International Tax Matters: Challenges and Remedies, European Parliament, Directorate-General for Internal Policies, Policy Department A - Economic, Scientific and Quality of Life Policies, February 2019.

[19] European Parliament resolution of 18 December 2019 on fair taxation in a digitalised and globalised economy: BEPS 2.0 (2019/2901(RSP)).

[20] William Byrnes (Texas A&M University Law), BEPS' Bait & Switch: OECD Pillar II GloBE Comments and Recommendations, Kluwer International Tax Blog, Wolters Kluwer, December 5, 2019, http://kluwertaxblog.com/2019/12/05/beps-bait-switch-oecd-pillar-ii-globe-comments-and-recommendations/?doing_wp_cron=1596608967.5873351097106933593750 (visited 5/8/2020), according to which *"From this statement it can be clearly inferred that from the origination of the BEPS project, supported by the Inclusive Framework, the issue was not about 'no or low taxation of the income' but rather BEPS has been concerned to address cases of double non-taxation or no or low taxation associated with practices that artificially segregate taxable income from the activities that generate it. Therefore, defining the scope of Pillar 2 as a global anti-base erosion (GloBE) proposal which seeks to address remaining BEPS risk of profit shifting to entities subject to no or very low taxation appears misleading and it does not fit into the original definition and the original mandate of the BEPS project."*.

[21] The Programme of Work refers to this mixing of income from different sources as "blending".

jurisdictions have not exercised their primary taxing rights or the payment is otherwise subject to low levels of effective taxation"[22].

V. Final Conclusions

It is doubtless that a new global tax reform is underway. New rules are designed and proposed, in order to cover all potential aspects of taxation, in view of the rapid digitalization of economy and, consequently, all the revised, updated and digitalized business models that have emerged. In this context, these new rules grant new taxing rights to the countries where users of highly digitalised business models are located.

The reinforcement of the arm's length principle, even if it is retained in the end, as a basic underlying principle of the existing transfer pricing rules worldwide, with the introduction of certain formulae for allocating taxing rights and profits and the establishment of a new nexus, ignoring the traditional rule, according to which a non-resident company is taxable on its business profits only if it has a permanent establishment constitute basic points of the new proposed strategy. The elaboration of the concepts of "significant economic presence", "user participation" and "marketing intangibles" within the frame of the Unified Approach contribute in a coherent and concurrent review of the profit allocation and nexus rules. Moreover, Pillar II aims at ensuring that the profits of internationally operating businesses are subject to a minimum tax rate, thus discouraging taxpayers from engaging in profit shifting practices and establishing a floor for tax competition among jurisdictions.

However, it should be highlighted that the final design and implementation of the two-pillar approach adopted, should be in line with some core and fundamental taxation principles, such as the principle of fair taxation and tax certainty, the elimination of double or even multiple taxation as well as the need for low administrative burden, as regards the compliance costs and all the design and procedural complexities. In any case, it is of vital importance to safeguard neutrality among different business models and capture equally all forms of remote involvement in the economy of a market jurisdiction, while at the same time ensure alignment of substance and profit. Last but not least, simplicity, stabilisation of the tax system, and increased tax certainty in implementation are regarded as key factors that should also be taken into account, in this respect.

[22] CFE Tax Advisers Europe Response to the OECD Public Consultation Document: GloBE Proposal Under Pillar Two Submitted by CFE to the OECD on 2 December 2019, Opinion Statement.