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Tenth Edition

Editor
Tim Sanders

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PREFACE

Many of the jurisdictional tax changes highlighted in the chapters in this volume reflect global tax trends that are likely to continue in 2020 and beyond. Some of these trends merit special mention in this preface.

One such area of material change is the taxation of the digital economy and this edition has a chapter dedicated to this topic. Although OECD attempts to find a consensus-based solution continue, notably with the publication on 9 October 2019 of proposals for a 'unified approach', many countries, frustrated by the time it will take to introduce concrete measures, have decided to take unilateral action, pending an international solution. In Europe, laws have been introduced or are pending in Austria, Belgium, the Czech Republic, France, Hungary, Italy, Poland, Slovenia, Spain and the United Kingdom and outside of Europe other countries are also introducing or proposing new laws, including Malaysia, Chile, Uruguay and Colombia. These domestic laws are likely to be a source of political tension with the United States, which sees such taxes as a threat to major US multinationals such as Google, Facebook and Amazon. This tension manifested itself in December 2019 when the United States threatened France with tariffs on key French exports to the United States on items such as champagne and sparkling wine, cheese, make-up, handbags and homeware such as porcelain and bone china, in retaliation for the introduction of the French digital services tax.

Another area where tax reform already introduced in some countries is likely to expand into other jurisdictions in 2020 is in the area of interest limitation rules. The OECD proposed limiting a tax deduction for net interest expense to 30 per cent of taxable EBITDA. This rule has been adopted in Germany, the United Kingdom and the United States and other EU countries are required to implement similar rules by 2022. It is important that groups review their cross-border financing in the light of these changes particularly as, unlike the case with transfer pricing, there is unlikely to be a right to exempt a receipt from tax in the recipient country when a deduction is denied in the paying country.

The effect of the wide-ranging US tax reform continues to impact the approach of US multinational groups to their overseas subsidiaries and one can expect further impact in 2020 as US groups re-evaluate their non-US financing and treasury operations.

It is hoped that this volume will prove to be a useful guide to the tax rules in the jurisdictions where clients conduct their businesses. Each chapter aims to provide topical and current insights from leading experts on the tax issues and opportunities in their respective jurisdictions. While specific tax advice is always essential, it is also necessary to have a broad understanding of the nature of the potential issues and advantages that lie ahead; this book provides a guide to these.

I should like to thank the contributors to this book for their time and efforts, and above all for their expertise. I would also like to thank the publisher and the team for their support and patience. I hope that you find the work useful, and any comments or suggestions for improvement that can be incorporated into any future editions will be gratefully received.

The views expressed in this book are those of the authors and not of their firms, the editor or the publishers. Every endeavour has been made to ensure that what you read is the latest intelligence.

Tim Sanders
London
January 2020

Chapter 1

INTRODUCTION TO THE CHALLENGES OF TAXING THE DIGITALISED ECONOMY

Alex Jupp, Joshua Atkinson and Alex Rigby[1]

In October and November 2019, the Organisation for Economic Co-operation and Development (the OECD) released two public consultation documents as part of its work on the taxation of the digital economy ('digital taxation'). The first outlined the OECD Secretariat's Proposal for a 'Unified Approach' under Pillar One (Reallocation of Profit and Revised Nexus Rules), and the second its Global Anti-Base Erosion Proposal under Pillar Two. These publications are key developments in the international conversation on the tax challenges arising from the digitalisation of the economy; challenges that have received increasing focus from policy-makers, advisers and taxpayers alike.

The challenges posed by digital taxation are well explored, with commentators (including the OECD) highlighting the novel aspects of value creation in digitised businesses, such as scale without mass, a heavy reliance on intangibles, and the role of data and user participation, which together allow the creation of value by activities closely linked to a jurisdiction without the necessity of physical presence.[2]

The consultation documents were released against a background of various unilateral measures and proposals (including digital services taxes (DSTs)) by jurisdictions seeking to ensure that they receive a greater (some would argue, fairer) share of the taxation payable by highly-digitised business models. Some of these unilateral measures have been implemented despite opposition and potential retaliation from the United States.

This chapter will highlight and categorise these unilateral measures, identifying commonalities of approach and exploring what links these ideas to the work of the OECD, outline the most recent proposals by the OECD and discuss key aspects of, and potential issues with, the proposal.

Developments in the sphere of digital taxation occur almost daily. This chapter speaks to the state of affairs as at 10 December 2019.

I THE OECD'S 2015 FINAL REPORT AND THE FIRST WAVE OF DIGITAL TAXES

Before the publication of the OECD's Action 1: 2015 Final Report (the Final Report), very few jurisdictions had implemented unilateral measures. The Final Report looked at a number of possible short-term solutions to the challenges of digital taxation. The most prominent and influential were: (1) a new nexus based on 'significant economic presence'; (2) a withholding

1 Alex Jupp is a partner and Joshua Atkinson and Alex Rigby are associates in the UK tax group of Skadden, Arps, Slate, Meagher & Flom (UK) LLP.

2 OECD February Consultation, para. 12.

tax on certain types of digital transactions; and (3) an equalisation levy.[3] These solutions were broadly mirrored by the three solutions assessed in the EU Commission's 2017 Report on Digital Taxation (the 2017 Report):[4] (1) an equalisation levy; (2) a withholding tax on digital transactions; and (3) a levy on revenues generated from the provision of digital services or advertising activity that 'could be applied to all transactions concluded remotely with in-country customers where a non-resident entity has a significant economic presence'.[5]

While no solution was recommended in either the Final Report or the 2017 Report, both acknowledged the need for action. The Final Report stated that '[c]ountries could . . . introduce any of these three options in their domestic laws . . . to account for the time lag between agreement . . . at the international level' and implementation.[6] The 2017 Report contained a similar acknowledgement.[7] By implying that countries both had the right to tax revenues they could not access under current laws and were justified in adopting such solutions, the OECD and the European Union (EU) opened the doors to, and provided the blueprint for, the implementation of unilateral measures that attempt to address these issues. Unilateral measures can take many forms; the categories adopted for discussion in this chapter are:

a DSTs;
b DSTs based on consideration (Consideration DSTs);
c withholding taxes;
d extended concepts of permanent establishment (PE); and
e indirect taxes (which are predominantly outside of the scope of this chapter).

The equalisation levy, a withholding tax and the reassessment of the concept of PE proposed by the EU and the OECD are digital taxes within the consensus international tax framework. The DST proposed by the EU (its third solution) both attempts to expand the tax base and tax value as yet untaxed. It is this second aim that distinguishes DSTs from other unilateral measures.

II DSTS

DSTs represent a rudimentary and imprecise means of taxing the perceived value targeted by most of the OECD's proposals. By taxing gross revenues, DSTs seek to tax value created by persons in a jurisdiction currently not covered by conventional taxes.

The first DST was proposed in March 2018 by the EU in its proposal paper setting out long-term and short-term digital taxation solutions (the Policy Paper).[8] This was intended as a short-term stop-gap and was based on the third solution in the 2017 Report: an 'indirect tax [that] would apply to revenues created from certain digital activities which escape the current

3 Final Report, pp. 13, 132, 136–137.
4 Commission, 'A Fair and Efficient Tax System in the European Union for the Digital Single Market', 21.9.2017, COM(2017) 547 final.
5 2017 Report, p. 10.
6 Final Report, p. 317.
7 2017 Report, p. 9.
8 https://ec.europa.eu/taxation_customs/business/company-tax/fair-taxation-digital-economy_en (Policy Paper).

tax framework entirely'.[9] As drafted, the EU DST would apply to revenues of activities or services that derive substantial value from users and that are '[hard] to capture with current tax rules'.[10] The EU DST would be charged at 3 per cent on revenues derived from:

a the selling of online advertising space;
b digital intermediary activities allowing users to interact and facilitating the sale of goods and services between them; and
c the selling of data generated from information provided by users.[11]

Only companies with total annual worldwide revenues of €750 million and EU revenues of €50 million would be taxable under the DST.[12] The thresholds embedded in the DST arguably represent a variation on the concept of 'significant economic presence' and, by encompassing more than simply services provided for consideration, on the scope of taxable activities and revenues identified as generating untaxed value.

One interesting aspect of the proposed EU DST and the DSTs modelled after it is the challenge of determining what falls within the parameters of taxable revenue. This affects both the where (PE/nexus) and what (taxable value) questions of taxation.[13]

i France

The French DST offers a much wider approach to both of these questions. France introduced its own DST in July 2019, with retroactive effective from 1 January 2019.[14] This DST is still in force and has inspired many others. The French DST is levied on two types of digital services:

a Intermediary services: which provide a digital interface enabling users to enter into contact and interact. Certain specific services (including some communication and payment services) are excluded.
b Advertising services reliant on user data: which provide services allowing advertisers to place targeted advertising messages on a digital interface based on data collected about users and generated upon the consultation of such interface. This includes the purchase and storage of advertising messages, advertising monitoring, and performance measurement, as well as the management and transmission of user data.[15]

9 Proposal 2: An interim tax on certain revenue from digital actives, Policy Paper.
10 Why Do We Need New Rules for the Taxation of the Digital Economy?, Policy Paper.
11 Article 3(1), 'Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, 2018/0073' (EU DST Legislation).
12 Article 4, EU DST Legislation.
13 Policy Paper, p. 7.
14 https://news.bloombergtax.com/daily-tax-report-international/insight-frances-digital-services-tax-goes-ahead-1.
15 Article 1, LOI n. 2019-759 (Fr.) (July 24, 2019); see Law No. 2019-759 (July 24, 2019) 'Concerning Creation of a Tax on Digital Services and Modification of the Downward Correction of the Corporation Tax' (translation) (French DST Legislation). Translation taken from Appendix 1 of the US Trade Representative's 'Report on France's Digital Services Tax Prepared in the Investigation under Section 301 of the Trade Act 1974', 2 December 2019.

While the scope of intermediary services is similar to the proposed EU DST, the French DST catches all players involved in the placing of advertising rather than just those placing the final advert or facilitating it.[16]

The French DST features thresholds similar to that of the proposed EU DST (€750 million of worldwide revenue and €25 million of French revenue (cf. €50 million of EU revenue)).[17] Unless France accounts for at least 50 per cent of EU revenues, in practice, the French thresholds are higher and therefore appear to target only certain larger multinationals.

The EU and French DSTs have formed the basis of many of the other DSTs that have been proposed or introduced. The DSTs proposed in Israel,[18] Canada[19] and the DST recently introduced in Italy[20] are modelled on the French DST and the DST awaiting approval in Spain[21] and the DSTs proposed in Belgium[22] and the Czech Republic[23] are modelled on the EU DST. Both the Czech DST and the DST recently enacted in Turkey have higher tax rates (7 per cent and 7.5 per cent, respectively) than the 2 to 3 per cent adopted in most other proposals.[24]

ii The UK

In July 2019, the UK published its own draft DST.[25] The principal difference between the UK DST and those already discussed is the approach to taxable revenues. The UK DST is targeted at specific business models rather than types of services: the draft legislation charges a 2 per cent tax on UK revenues of internet search engines, social media platforms and online marketplaces[26] and any associated online advertising undertaken by any such businesses.[27]

16 Bob Michel, 'The French Crusade to Tax the Online Advertisement Business: Reflections on the French Google Case and the Newly Introduced Digital Services Tax', European Taxation, November 2019, pp. 535–536.

17 Article 1, French DST Legislation.

18 https://tax.thomsonreuters.com/blog/israel-preparing-digital-services-tax-modelled-off-pending-french-proposal/.

19 https://news.bloombergtax.com/daily-tax-report-international/canadas-trudeau-proposes-french-style-digital-services-tax.

20 See R-A Papotti and M Caziero, 'Analyzing the Italina Digital Servicees Tax Through European Glasses', Tax Notes Int., Nov 4, 2019. See also, P. Ludovivi, 'Chapter 12: Taxing the Digital Economy: The Italian Digital Services Tax in Taxing the Digital Economy: The EU Proposals and Other Insights' (P. Pistone & D. Weber eds., IBFD 2019) Books IBFD (Italian DST in Taxing the Digital Economy). Note that the Italian DST is awaiting implementing measures (it is meant to become effective from 1 January 2020).

21 https://news.bloombergtax.com/daily-tax-report-international/insight-the-new-spanish-digital-service-tax-a-strange-combination-of-value-creation-and-geolocalization.

22 https://news.bloombergtax.com/daily-tax-report-international/belgium-mulls-plan-to-tax-digital-companies.

23 https://www.reuters.com/article/us-czech-taxation-digital/czech-government-approves-digital-tax-aimed-at-internet-giants-idUSKBN1XS1XU.

24 https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-turkey-28-october-2019.pdf.

25 Draft legislation was published in the UK's Finance Bill 2019 – 2020 (the UK DST Legislation). UK DST was intended to be introduced in 2020 but this may be delayed as a result of the general election. At the time of writing, the UK is still an EU nation, although domestic legislation has been enacted to effect its departure on 31 January 2020.

26 Clauses 2(2), 4(2) and 8(2), UK DST Legislation.

27 Clauses 4(6) and (7), UK DST Legislation.

UK revenues are defined as those that can be attributed to a user who it is reasonable to assume is either an individual normally resident in the UK or a business established in the UK.[28]

While the UK DST has thresholds akin to those in other DSTs and a similar UK specific threshold of £25 million, its global revenue threshold of £500 million is much lower than the €750 million in the EU and French DSTs.[29] The UK DST excludes the first £25 million of taxable revenues and contains a safe harbour provision for businesses with low profit margins or those that record a net loss, allowing a group to divide its various chargeable activities to exempt the loss-making taxable activities from the DST and to subject the activities with a slim profit margin to a lower charge.[30]

iii The influence on other DSTs

While tax authorities disagree over the introduction of DSTs and to which revenues and services these new taxes should apply, political impetus for DSTs (in particular those based on the French or EU model) seems to be growing. Common among the DSTs surveyed is the idea that, within the profits of a company or group, an amount derived from user value and that value should be taxed in a market jurisdiction.

III CONSIDERATION-BASED TAXES

Most other unilateral measures do not look to tax untaxed value but rather seek to bring into a charge to tax or increase the tax on certain services provided for consideration. Consideration DSTs, equalisation levies and withholding taxes all contain these features.

i Consideration DSTs

In April 2019, Austria published draft legislation for a DST that would, from 1 January 2020, tax online advertising services provided for consideration by companies with worldwide advertising revenues of at least €750 million and Austrian revenues of €25 million at a rate of 5 per cent.[31]

Similarly, after its initial tiered advertising tax was declared to be in violation of EU law by the European Commission (the Commission),[32] effective as of 1 July 2017, Hungary introduced a 7.5 per cent tax on revenues from advertisements that are published in the Hungarian language, or where an advertisement is not published in the Hungarian language but is available on a website that is mainly displayed in the Hungarian language. The first 100 million forints of revenue is taxed at zero per cent.[33]

28 Clause 5, UK DST Legislation.

29 The Italian DST also has this same threshold. See, R-A Papotti and M Caziero, 'Italian DST in Taxing the Digital Economy'.

30 This is expected to be beneficial to businesses that have a taxable business model with a profit margin under 2.5 per cent (see, H. Buchanan and other, 'The UK's proposed digital services tax', Tax Journal, Nov 2018).

31 https://news.bloombergtax.com/daily-tax-report-international/austria-lower-house-passes-bill-to-implement-digital-services-taxation-eu-directive-on-cross-border-arrangements.

32 https://www.tax-news.com/news/EU_Court_Rules_For_Hungary_In_Advertising_Tax_Dispute____97182.html.

33 https://taxinsights.ey.com/archive/archive-news/hungary--advertisement-tax-amended.aspx.

Rather than tax digital services as a whole (or a large proportion thereof), consideration DSTs specifically target one form of digital service: advertising services provided for consideration. With this explicit focus, they equalise the treatment of online and conventional businesses and more easily tax a specific metric of value; the consideration paid for the service. In so doing, jurisdictions may be attempting to make their tax systems horizontally equitable (so that similar business models are taxed in similar ways) rather than tap into an as yet domestically untaxed revenue stream.

ii Equalisation levy

Equalisation levies also function to equalise the tax treatment of the digital and conventional economies. [34] In 2016, India became the first, and only to date, jurisdiction to introduce a pure digital 'equalisation levy'.[35] India specifically mentioned the suggestion by the OECD when introducing the levy.[36]

Like the two consideration DSTs discussed above, the 'equalisation levy' taxes revenues derived from online advertising, specifically 'online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement' at a rate of 6 per cent. To 'equalise' treatment, the levy only applies to taxable services provided by a non-resident (other than a non-resident with an Indian permanent establishment) that are received or receivable by an Indian resident conducting a business or profession or a non-resident's Indian permanent establishment.[37] Thus, the Indian equalisation levy seeks to establish equality between Indian businesses and non-Indian businesses providing services into India (rather than digital services as a whole irrespective of by whom they are provided). Similar to DSTs and consideration DSTs, equalisation levies include an economic nexus in the form of a threshold requirement of aggregate consideration between the parties of at least 100,000 rupees.[38]

iii Withholding

On 16 March 2018, the Malaysian Inland Revenue Board published a practice note stating that income from the provision of digital advertising services earned by non-residents without a Malaysian PE would be subject to withholding at a rate of 10 per cent (unless reduced by a treaty) as either royalty or service income. This provides an example of recharacterising income to bring it into a charge to tax under the current international framework.

Turkey introduced a similar withholding provision into its tax law, effective 1 January 2019, placing a 15 per cent withholding on payments for online advertising services when they are provided by non-resident persons. Pakistan has introduced withholding at 5 per cent on consideration provided for an even wider array of digital services.

Withholding taxes are comparatively easy to introduce and are usually levied at higher rates than other unilateral measures discussed in this chapter (compare the UK DST rate of 2 per cent and the Turkish withholding at 15 per cent). However, notwithstanding their simplicity, withholding taxes have not proved to be a universally popular form of digital taxation and relatively few are in play at present.

34 G. Kofler, 'Equalization Taxes and the EU's "Digital Services Tax"', 47 Intertax 2, p. 183 (2019).
35 Chapter VIII, Finance Act 2016 (FA).
36 Memorandum Explaining the Provisions of the Finance Bill, 2016, p. 5.
37 Section 165(1), FA.
38 Sections 165(2) and 166, FA.

iv Extending the definition of PE

All of the unilateral measures discussed above (other than withholding) seek, to some extent, to tax persons with an economic presence in the jurisdiction that does not amount to a PE in the traditional sense. Certain jurisdictions, however, have further sought to amend the definition of PE within their domestic tax legislation.

Following the Final Report, the Israel Tax Authority (ITA) announced in April 2016 that it would tax income of digital businesses that had 'significant economic presence' in Israel. Indicators of such a presence included a substantial number of online transactions with Israeli residents, the provision of online services, the use of services provided by non-residents being used by a large number of Israelis and a correlation between consideration and the user base in Israel. This approach, however, has proven unsuccessful and the DST mentioned above is intended to replace it.[39]

The EU's longer term proposal in the Policy Paper was to introduce the concept of a virtual PE and 'enable Member States to tax profits that are generated in their territory, even if a company does not have a physical presence there'.[40] A digital platform would be taxable if it had a 'digital presence' or virtual permanent establishment in a Member State as a result of its annual revenues, number of users or number of business contracts entered into in, or with residents of, a Member State. The Commission was so committed to this idea that it advised Member States to renegotiate their tax treaties to include 'significant economic presence' within the concept of permanent establishment.[41] Romania, for example, stated that it would seek to renegotiate its treaties on this basis[42] and Belgium, alongside publishing a draft DST, published a draft bill to include 'significant economic presence' within its concept of a 'Belgian institution' for the purposes of establishing a PE.[43] Similar measures have been considered in other jurisdictions, such as South Korea.[44]

v A US hybrid – example of indirect taxes

While indirect taxes predominantly fall outside the scope of the chapter (as they are not derived from the OECD's work leading to Unified Approach), their introduction should be noted. Although many developments in digital taxation have faced opposition from the US federal government, US states have been active in implementing their own digital taxes in the form of indirect sales taxes on consumers. These taxes are an attempt to equalise the treatment of brick-and-mortar retailers physically present in the relevant state and larger online distributors with no such presence. These taxes share many similarities with consideration DSTs and equalisation levies.

Some states have specifically targeted the sale of certain digital services, such as streaming services. In 2015, Chicago expanded its 9 per cent amusement tax, enacted to tax sporting or concert tickets, to cover streaming services.[45] In 2016, Pennsylvania expanded

39 www.lexology.com/library/detail.aspx?g=4101bdb6-f3a4-4b65-b61c-842e0e224bff.
40 Proposal 1: A common reform of the EU's corporate tax rules for digital services, Policy Paper.
41 Commission, 'Commission Recommendation of 21.3.2018 relating to the corporate taxation of a significant digital presence', Brussels 21.3.2018 C(2018) 1650 final.
42 Parliament Decisions No. 68 and 69 of 23 May 2018, 'Official Gazette of Romania', No. 435.
43 https://news.bloombergtax.com/daily-tax-report-international/belgium-mulls-plan-to-tax-digital-companies.
44 https://tax.thomsonreuters.com/blog/south-korea-evaluating-digital-tax-measures.
45 Amusement Tax Ruling #5, Electronically Delivered Amusements, Chicago Dep't of Fin. (9 June 2015).

its 6 per cent sales tax to cover both streaming services and other downloadable services.[46] Other states, including Alabama,[47] Illinois,[48] Louisiana,[49] Maine[50] and West Virginia[51] have considered similar taxes.

More recently, general digital sales taxes have increased after the US Supreme Court decision of *South Dakota v. Wayfair*.[52] This case overturned previous case law and held that states may collect taxes on internet sales even when the purchaser does not have a physical presence in the state. Essentially, this judgment accepted that entities could be taxable if they had a sufficient economic nexus in a state. Subsequently, over 40 states have amended their tax laws to account for this change in law.[53]

While these indirect taxes are levied on the consumer, they embody many of the concepts seen in other forms of digital taxation: in particular they seek to equalise tax treatment across business and to expand the concept of a PE. However, what these taxes do not address and what DSTs are trying to accomplish is to locate as yet untaxed user value not covered by 'standard' forms of taxation.

IV OECD PROPOSALS

Since the call for further reports and work on Action 1 within the Final Report,[54] the OECD has released a number of key publications and held consultation meetings regarding digital taxation.[55] Most recently,[56] the OECD Secretariat has released its consultation documents on its (1) Proposal for a 'Unified Approach' under Pillar One (the Unified Approach); and (2) Global Anti-Base Erosion Proposal under Pillar Two (the GloBE Proposal), as well as holding a consultation meeting on Pillar One. The GloBE Proposal envisages, *inter alia*, an income inclusion rule and tax on base-eroding payments, together designed to define a global minimum tax and strengthen anti-abuse provisions in a post-BEPS world.[57] While the GloBE Proposal is likely to play an important role in any international digital taxation regime adopted,[58] we will focus on the Unified Approach and the interactions between, and cross-influences seen in, the proposal and DSTs.

46 Pennsylvania's Act 84 of 2016.

47 www.govtech.com/budget-finance/Alabama-Proposes-Taxes-on-Streaming-Services-Like-Netflix-Spotify.html.

48 Illinois' House Bill 3359.

49 Louisiana's House Bill 655.

50 20-C, An Act Making Unified Appropriations and Allocations for the Expenditures of State Government, General Fund and Other Funds, and Changing Certain Provisions of the Law Necessary to the Proper Operations of State Government for the Fiscal years Ending 30 June 2018 and 30 June 2019.

51 www.csgmidwest.org/policyresearch/0417-qom.aspx.

52 138 S.Ct. 2080.

53 www.forbes.com/sites/kellyphillipserb/2019/10/02/new-sales-tax-rules-take-effective-this-week-in-more-than-a-dozen-states/#5da953bb5cfb.

54 Final Report, para. 361.

55 For further details, see Unified Approach to Pillar One, paras 1–6.

56 At time of writing.

57 GloBE Proposal, para. 5.

58 And could be seen as the more effective first step, see Moises Dorey, 'A Road Map for Reaching Global Consensus on How to Tax the Digitalized Economy', International Transfer Pricing Journal, 2019 (Volume 26), No. 5, Section 3.

i Unified Approach

The Unified Approach states an aim to reallocate existing taxing rights to market jurisdictions while maintaining administrability.[59] The OECD identified reallocation as motivating all three proposals in its Programme of Work that defines the scope of Pillar One,[60] namely 'user participation', 'marketing intangibles' and 'significant economic presence' proposals.[61] In short, each of these proposals suggests:

a User Participation, where an amount of profit is allocated to jurisdictions to reflect value generated by active and participatory user bases, irrespective of physical presence.[62]

b Marketing Intangibles, created in market jurisdictions through the active and (remote) participation of a multinational enterprise (MNE). As a result, a portion of the MNE's residual income should be allocated to the market jurisdiction (either using the arm's-length principle (the ALP) or a revised profit split).[63]

c Significant Economic Presence, where taxable presence arises if sufficient factors show interaction with a jurisdiction through digital technology.[64]

The OECD developed the Unified Approach based on identified commonalities within the three proposals (such as a new nexus rule independent of physical presence).[65] The Unified Approach proposes a three-tier mechanism including:

a Amount A – the 'New Taxing Right' under the OECD's proposal, this amount is a jurisdiction's fractional entitlement to deemed non-routine profits, calculated by:
- identifying standardised MNE profit (possibly on a business-segment basis);
- apportioning part of this profit between routine returns to activities in jurisdictions where the MNE is resident (as traditionally understood). Routine returns may be proxied by a percentage of return on sales;
- further dividing the remaining non-routine profits, a proportion being attributable to certain non-routine activities (such as trade intangibles and synergies) with the remainder allocable to market jurisdictions; and
- apportioning this amount to each market jurisdiction using (as it appears) local revenues (which, in the case of business operated via a remote presence, would likely be tied to user or consumer location) to generate Amount A.

b Amount B – the tax due on the routine distribution and marketing operations in each market jurisdiction. This amount may, for simplification purposes, use a fixed percentage return to estimate the profits of such baseline activities.

c Amount C – an additional amount above Amount B that may be allocated to a jurisdiction using the ALP where an MNE's activities there exceed the routine activities

59 Unified Approach, para. 13.
60 OECD Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy, available at: www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.htm.
61 Unified Approach, para. 4.
62 OECD February Consultation, paras 17–28.
63 OECD February Consultation, paras 29-49.
64 OECD February Consultation, paras 50-54.
65 Unified Approach, para. 13.

that are compensated through Amount B.[66] This amount may include both routine returns for activities other than distribution and marketing as well as non-routine returns determined by application of the ALP.

This system, as currently outlined, will apply to consumer-facing businesses (rather than just highly-digitised business models), creates a new nexus independent of physical presence, and includes a new profit allocation rule that moves beyond the ALP.[67]

V COMBINATION OF PROPOSALS WITHIN THE PROGRAMME OF WORK

Although the OECD has continued its work to meet the tight 2020 deadline, the complexity of the issue, and the conflicts of interest between the various (and often overlapping) groups of stakeholders mean that achieving balance between the interests of countries involved in the OECD project is not straightforward.[68] The stakeholders could be grouped into:

a Headquarter jurisdictions – Where the intangibles that are attributed profits under the ALP are largely located, leading to a large allocation of residual profits. However, these jurisdictions also deal with reductions in their tax base because of credits given for unsuccessful investments.

b Market jurisdictions – Contain a large number of digital consumers despite digital MNEs having limited or no physical presence. Under traditional tax principles, the operations of MNEs in these countries will not amount to a permanent establishment, nor will significant profits be allocated under the ALP.

c Developing jurisdictions – Similar concerns to market jurisdictions, but the tax authorities of these countries are in favour of a simple, administrable regime, given limitations in tax authority function.[69]

Indications of these differing attitudes can be seen in their reactions to the introduction of DSTs. Market jurisdictions have generally instigated the measures, headquarter jurisdictions have generally met implementation of DSTs with hostility and are resistant to giving credit for DST payments,[70] and developing jurisdictions have adopted a variety of different measures, some of which are conceptually similar to a DST (i.e., all are akin to an excise tax), [71] but others which are organised around more easily measurable metrics than revenue, such as levies on access to social media.[72]

66 Unified Approach, para. 30.

67 Unified Approach, para. 15.

68 Factors described as 'insurmountable' by certain commentators, see Dorey, *supra* n.58, at section 1.

69 Liu, Reyneveld and Straatman, 'OECD's Work on the Digital Economy: Impact Far Beyond the Digital Economy', International Transfer Pricing Journal, 2019 (Volume 6), No. 5, Section 4.

70 New York Times, 'U.S. Announces Inquiry of French Digital Tax that May End in Tariffs', 10 July 2019, available at: www.nytimes.com/2019/07/10/business/us-france-tariffs.html.

71 Congressional Research Services, 'Digital Services Taxes (DSTs): Policy and Economic Analysis', 25 February 2019, p. 8, available at: https://fas.org/sgp/crs/misc/R45532.pdf.

72 IMF Policy Paper, 'Corporate Taxation in the Global Economy', para. 26, available at: www.imf.org/~/media/Files/Publications/PP/2019/PPEA2019007.ashx.

The melding of all three proposals under Pillar One within the Unified Approach could be seen as an attempt to provide a 'pragmatic fudge',[73] with Pascal St Amans, the Director of the Centre of Tax Policy and Administration at the OECD, stating in October 2019 that unanimity is not required for new digital taxation to move forward.[74] Hints of a compromise can be seen in the combination of: (1) the provision for an allocation (outside the ALP) of residual profits to market jurisdictions through Amount A, recognising the right to tax value asserted by DST-supporting jurisdictions; with (2) the utilisation of the ALP in determining Amount C, showing a desire to retain some utilisation of existing transfer pricing principles.

Considering the increasing number of DSTs and other unilateral measures discussed above,[75] and given the pressure from the G20 for a solution, political compromise appears to be necessary.[76] The OECD is trying to lead a unified solution, while satisfying (or at least placating) all interested parties. Desire to lead the way may arise from concern that a continuing lack of consensus could perpetuate 'interim' DSTs, much like UK income tax ended up surviving the Napoleonic Wars.[77]

VI DEPARTURE FROM THE ALP

One of the most radical aspects of the Unified Approach is its proposal of a departure from the ALP. St Amans acknowledged in August 2019 that 'it was something of a shock . . . that the OECD – the organisation that wrote the bible on arm's length – would have doubts about the ALP'.[78]

However, doubts about the suitableness of the ALP as the primary tool of the international tax regime are not new. For example, following the release of the new OECD Model Treaty in 2010, countries including India reserved the right to incorporate the 2008 version of Article 7 into their double tax treaties, believing that the reference to the fractional apportionment in the earlier version provided more suitable tools to carry out an apportionment of profits based on where value is created.[79]

Also arguable is whether fractional apportionment has appeared previously in OECD guidance. Some argue that the DEMPE functions introduced as part of the Final Report on Action 8-10 of the BEPS project reveal that the OECD was willing to adopt formulary apportionment at that time, even if it wasn't willing to label it such.[80]

73 The Final Report on Actions 8-10 in 2015 was similarly described by Andrew Hickman, former head of the OECD transfer pricing unit, see R. Finley, 'OECD Took a Pragmatic Approach to Arm's-Length Principle, Hickman Says', 22 July 2016, Tax Analysts.

74 'Unanimity not required to update global rules for taxing multinational groups, OECD's Saint-Amans says', MNE Tax, October 18, 2019, available at: https://mnetax.com/unanimity-not-required-to-update-rules-for-taxing-multinational-groups-oecds-saint-amans-says-36188.

75 These are exerting 'heavy pressure', see Liu, footnote 69, at sections 1 and 2.

76 Communiqué, G20 Finance Ministers and Central bank Governors Meeting, Fukuoka (8–9 June 2019), para.11.

77 War and the coming of income tax, Living Heritage, Parliament.uk, available at: www.parliament.uk/about/living-heritage/transformingsociety/private-lives/taxation/overview/incometax.

78 J. White, 'Big tech changed everything for international tax', ITR (22 Aug 2019).

79 Ranjan Das, 'Is the Arm's-Length-Principle-Based Authorised OECD Approach to the Attribution of Profits to a Permanent Establishment Losing its Authority?', Bulletin for International Taxation, 2019 (Volume 73), No. 12.

80 Wilkie, 'New Rules of Engagement? Corporate Personality and the Allocation of 'International Income' and Taxing Rights, in Brian J. Arnold Ed., Tax Treaties After the BEPS Project A Tribute to Jacques Sasseville' (Toronto: Canadian Tax Foundation, 2018), 349–386.

VII UNCERTAINTIES

Many uncertainties surround whether, when, how, and by whom the Unified Approach will be adopted, as reflected in the questions asked at the end of the consultation paper.[81] All are of critical importance to businesses facing unprecedented uncertainties in planning their future models. However, none of the questions specifically address the merits of the proposal, so this 'pragmatic fudge' is likely to be the basis for the OECD's proposal in 2020.

Key questions that remain unanswered include the response of the US and other headquarter jurisdictions, particularly regarding whether they will participate in the new system, and whether they will allow foreign tax credit for any amounts payable under Amount A (or the Unified Approach more widely). The US Treasury Secretary stated in a letter to the OECD in December 2019 that the US has 'serious concerns' about aspects of the OECD's work under Pillar One.[82]

Further, the ways in which the OECD envisions the multilateral dispute mechanism required under the Unified Approach operating are not yet clear.[83] An effective dispute mechanism is crucial to avoiding double taxation if the Unified Approach is adopted, and must be a focus of: (1) the OECD in its work moving forward; and (2) those countries that choose to implement the Unified Approach in due course.

VIII CONCLUSION

It remains to be seen what, if any, unanimity among the various stakeholders can be forged around the Unified Approach. The authors take no position on whether the aim of reallocating existing taxing rights to market jurisdictions (howsoever implemented) is a desirable one or not, but strongly believe that any proposals to be adopted must be administrable, must not lead to double taxation, and must provide for strong and sensible dispute resolution. What is clear is that the concepts behind the short-term solutions and the three approaches considered by the EU remain influential on DSTs and the OECD's thinking. Both involved the creation of a new nexus independent of physical presence and both seek to tax value that is, as yet, domestically untaxed. The DSTs apply to specifically defined digital services or business models, whereas the Unified Approach now looks beyond the digital economy. The DSTs are predicated on the vague idea that a 'value' exists that should be taxed and rather than precisely isolating this value, the DSTs hope that the value (or part of the value) is then captured and taxed appropriately by the new regime. The Unified Approach attempts to achieve agreement on how to locate value and re-allocate profits accordingly in an (arguably) more scientific manner. That task is, however, much more difficult and much more politicised and it remains to be seen whether a consensus can be reached.

81 Unified Approach, pp. 17 & 18.

82 Secretary Mnuchin Letter to OECD Secretary-General, 3 December 2019.

83 The consultation document asks for comments on the appropriate mechanism, Unified Approach, p. 18.

Appendix 1

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