THE

Inward Investment and International Taxation Review

Eleventh Edition

Editor
Tim Sanders

THE LAWREVIEWS

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Eleventh Edition

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This article was first published in January 2021
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Published in the United Kingdom
by Law Business Research Ltd, London
Meridian House, 34–35 Farringdon Street, London, EC4A 4HL, UK

www.TheLawReviews.co.uk

ISBN 978-1-83862-797-3

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

ABOU JAOUDE & ASSOCIATES LAW FIRM

ADVOKATFIRMAET GRETTE AS

ÆLEX

AFRIDI & ANGELL

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PREFACE

This edition has been revised to describe domestic tax changes that have occurred in each jurisdiction since the last edition, including those made, and proposed, in response to the covid-19 pandemic. Where appropriate, the contributors also update the progress made in their respective jurisdictions in implementing laws to comply with the Base Erosion and Profit Shifting (BEPS) Actions.

The pandemic's economic impact has been profound, and while temporary reliefs have been introduced in many countries, and are described, at this stage it is unclear how countries will change their tax laws in the longer term and balance the need to recover the enormous costs of the pandemic with the desire to stimulate economic growth in contracting economies. How this conflict will evolve and be resolved seems likely to be the major tax story of 2021. This preface will make some tentative observations in this area.

As will be seen from the chapters herein, in 2020, countries continued to implement changes to their domestic laws to comply with BEPS Actions notably in respect of hybrid entities and instruments, controlled foreign companies and transfer pricing. One key area highlighted last year, which has progressed in 2020, is the taxation of the digital economy. In October 2020, the OECD published two blueprints and launched a public consultation as part of its work on the taxation of the digital economy. These blueprints are key developments in the international conversation on the challenges of taxing the digital economy. However, although the OECD has progressed efforts in 2020 to find a consensus, many countries, frustrated by the lack of concrete law, are progressing their own unilateral measures to tax the digital economy. For example, Spain's 'Google Tax' is due to come into force on 16 January 2021 and the United Kingdom has already introduced a Digital Services Tax. Pressure for unilateral action is likely to increase as countries look for new tax sources to recover revenue spent on fighting covid-19. Potentially taxation of digital companies allows many economies to raise material amounts of tax revenue without an adverse economic impact on the recovery in their own jurisdictions, where the digital taxpayers often have minimal presence and pay little tax. However, that analysis must factor in whether the US, that has most to lose (as many of the largest digital companies are US-based), will take retaliatory action. The previous political regime showed that it is willing to impose tariffs on goods imported from countries that unilaterally impose a digital tax. This is an area to watch carefully in 2021. The increased pressure to tax the digital economy because of the covid-19 pandemic has been acknowledged by the OECD, with the OECD Secretary-General stating on an online press conference on 12 October 2020 that digital businesses that are thriving during the pandemic would 'be the targets' of countries looking for resources to 'make ends meet'.

Many countries have introduced packages of short-term tax measures to help businesses and individuals through the pandemic. These may comprise deferring tax payments and extending filing deadlines, to subsidies such as those afforded to businesses that furloughed staff and measures allowing more generous loss carry-back. The question countries must face in 2021 is how long they can afford to provide these short-term reliefs and what will replace them. There is a lot of pressure to help certain sectors particularly hard hit by the pandemic such as tourism and hospitality and, for example, Austria's reduction in VAT to 5 per cent on restaurants, and admission to cultural events for 2021 is the sort of measure one might expect to be introduced elsewhere.

The wider question is how countries can reconcile the desire to provide economic support and stimulus for growth after the pandemic with the need to recover the budget deficit caused by covid-19 pandemic-related costs: how to raise additional tax from shrinking economies, without stifling any recovery. As referred to above, one obvious target is to tax the digital economy; another possible avenue is to introduce measures that encourage inward investment. It is also likely that in the drive to increase tax revenues, many tax authorities will take a far more aggressive and proactive approach to recover tax and penalties from tax payers regarded as non-compliant or participating in perceived tax avoidance. However, it would be naïve to imagine that these sorts of measures alone will be enough and even if one factors in tax changes in areas such as personal capital taxes, it seems likely that some increase in business and personal income taxes will be needed.

How US tax reform in 2021, post the presidential election, evolves is another factor likely to impact the wider tax landscape and is an area that needs to be kept under review.

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 2021

Chapter 1

THE CONTINUING CHALLENGES OF TAXING THE DIGITALISED ECONOMY: AN INTRODUCTION

Alex Jupp, Joshua Atkinson and Alex Rigby[1]

In October 2020, the Organisation for Economic Co-operation and Development (the OECD) released two blueprints and launched a public consultation as part of its work on the taxation of the digital economy ('digital taxation'). The first blueprint outlined the work by the Inclusive Framework[2] to date on 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.[3]

The covid-19 pandemic has not slowed the work of the Inclusive Framework on Pillar One, with the OECD Secretary-General recently stating that digital businesses that are thriving during the pandemic would 'be the targets' of countries looking for resources to 'make ends meet'.[4] Indeed, the blueprints were released against a background of the continuing development and implementation of 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

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 The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting ('Inclusive Framework') brings together over 125 countries and jurisdictions to collaborate on the implementation of the BEPS package (www.oecd.org/tax/beps/beps-about.htm/).

3 Pillar One Blueprint, Paragraphs 22 and 31; OECD February 2019 Consultation, Paragraph 12.

4 Angel Gurría, online press conference, 12 October 2020, available at: https://oecdtv.webtv-solution.com/7020/or/international_taxation_addressing_the_tax_challenges_arising_from_digitalisation_of_the_economy.html.

retaliation from the United States,[5] with any resulting trade tensions risking further losses of gross domestic product, considered to be 'unacceptable' in the context of the pandemic by the OECD.[6]

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 7 December 2020.

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 tax on certain types of digital transactions; and (3) an equalisation levy.[7] These solutions were broadly mirrored by the three solutions assessed in the EU Commission's 2017 Report on Digital Taxation (the 2017 Report):[8] (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'.[9]

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.[10] The 2017 Report contained a similar acknowledgement.[11] 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

5 According to a press release of 2 June 2020 from the Office of the US Trade Representative (USTR), the USTR is currently conducting investigations under Section 301 of the 1974 Trade Act with regard to digital taxes introduced or being considered by Austria, Brazil, the Czech Republic, the European Union, India, Indonesia, Italy, Spain, Turkey and the United Kingdom. The USTR concluded its investigation regarding France's DST in July 2020 (see, Notice of Action in the Section 301 Investigation of France's Digital Services Tax from 16 July 2020).

6 See footnote 4.

7 Final Report, pp. 13, 132, 136–137.

8 Commission, 'A Fair and Efficient Tax System in the European Union for the Digital Single Market', 21 September 2017, COM(2017) 547 final.

9 2017 Report, p. 10.

10 Final Report, p. 317.

11 2017 Report, p. 9.

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).[12] 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 tax framework entirely'.[13] 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'.[14] 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.[15]

Only companies with total annual worldwide revenues of €750 million and EU revenues of €50 million would be taxable under the DST.[16] 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.

12 https://ec.europa.eu/taxation_customs/business/company-tax/fair-taxation-digital-economy_en (Policy Paper).
13 Proposal 2: An interim tax on certain revenue from digital actives, Policy Paper.
14 Why Do We Need New Rules for the Taxation of the Digital Economy?, Policy Paper.
15 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).
16 Article 4, EU DST Legislation.

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.[17]

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.[18] 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.[19]

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.[20]

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)).[21] 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 DST introduced in Italy[22] and the DSTs proposed in Israel[23] and Canada[24] are modelled on the French DST and the DST recently introduced

17 Policy Paper, p. 7.

18 https://news.bloombergtax.com/daily-tax-report-international/insight-frances-digital-services-tax-goes-ahead-1.

19 Article 1, LOI n. 2019-759 (Fr.) (24 July 2019); see Law No. 2019-759 (24 July 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.

20 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.

21 Article 1, French DST Legislation.

22 See R-A Papotti and M Caziero, 'Analyzing the Italina Digital Servicees Tax Through European Glasses', Tax Notes Int., 4 November 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).

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

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

in Spain[25] and the DSTs currently proposed in Belgium[26] and the Czech Republic[27] are modelled on the EU DST. Both the proposed Czech DST and Turkey DST have higher tax rates (5 per cent and 7.5 per cent, respectively) than the 2 to 3 per cent adopted in most other proposals.[28]

ii The UK

The UK introduced a 2 per cent tax on UK revenues of internet search engines, social media services and online marketplaces and any associated online advertising undertaken by any such businesses, with effect from 1 April 2020.[29] The UK DST takes a different approach to taxable revenues to those already discussed by targeting specific business models rather than types of services. 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.[30]

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.[31] 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.[32]

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.

Absent any agreement by the OECD and the Inclusive Framework on Pillar One, more DSTs are expected to be implemented. Valdis Dombrovskis, executive vice president of the European Commission, has said that the EU will propose new draft legislation for an EU-wide DST in the first half of 2021 if no agreement is reached.[33] The African Tax Administration

25 Law 4/2020 on the Taxation of Certain Digital Services, 15 October 2020 (Section I, p. 88569, Boletín Oficial del Estado, No 274, 16 October 2020).

26 Proposition on the on the creation of a provisional tax covering the products generated by certain activities of digital giants, 29 March 2020, *Chambre des Représentants de Belgique*, Doc 55, 0096/005.

27 www.reuters.com/article/czech-internet-tax/update-1-czech-coalition-agrees-5-digital-tax-aimed-at-global-internet-giants-ctk-idUSL8N2DN4MC.

28 www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-turkey-28-october-2019.pdf. The Czech DST as originally proposed was intended to be levied at 7 per cent.

29 Sections 41 and 43, UK's Finance Act 2020 (FA 2020).

30 Section 44, FA 2020.

31 Section 46, FA 2020. The Italian DST also has the same worldwide threshold as the EU and French DSTs. See, R-A Papotti and M Caziero, 'Italian DST in Taxing the Digital Economy'.

32 Sections 47(3) and 48(4), FA 2020. 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).

33 www.internationaltaxreview.com/article/b1nfjnlpv95dfq/this-week-in-tax-eu-plans-to-announce-its-dst-in-2021.

Forum (ATAF) has noted the potential economic impact on African countries of a delay in reaching agreement and has published draft DST legislation that it suggests African countries should use if they consider introducing a DST.[34]

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

Effective from 1 January 2020, Austria has taxed 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.[35]

Similarly, after its initial tiered advertising tax was declared to be in violation of EU law by the European Commission (the Commission),[36] 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.[37]

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.[38] In 2016, India became the first, and only to date, jurisdiction to introduce a pure digital 'equalisation levy' (the Advertising Levy).[39] India specifically mentioned the suggestion by the OECD when introducing the levy.[40]

Like the two consideration DSTs discussed above, the Advertising Levy taxes revenues derived from online advertising, specifically 'online advertisement, any provision for digital

34 Suggested Approach to Drafting Digital Services Tax Legislation, 30 September 2020, ATAF'S Internation Taxation and Technical Assistance Publication.

35 Austrian Digital Tax Act 2020, Federal Law Gazette I No. 91/2019 (DiStG 2020).

36 Albeit that that decision was annulled by the General Court, www.tax-news.com/news/EU_Court_Rules_For_Hungary_In_Advertising_Tax_Dispute____97182.html. See also, that that annulment has recently been upheld in an option by Advocate General Kokott, Advocate General's Opinions in Cases C-562/19 *P Commission v. Poland* and C-596/19 *P Commission v. Hungary*.

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

38 G Kofler, 'Equalization Taxes and the EU's "Digital Services Tax"', 47 Intertax 2, p. 183 (2019).

39 Chapter VIII, Finance Act 2016 (FA 2016).

40 Memorandum Explaining the Provisions of the Finance Bill, 2016, p. 5.

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.[41]

In 2020, India introduced a second and distinct 'equalisation levy' at a rate of 2 per cent on consideration received by non-resident e-commerce operators for e-commerce supplies with a certain nexus to India or where the consideration is received from a person resident in India (the General Levy). Like the Advertising Levy, the General Levy is not applicable if the consideration relates to an e-commerce operator's Indian permanent establishment. Furthermore, the General Levy will not apply if the Advertising Levy is applicable.

Thus, the Advertising Levy and the General Levy seek 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.[42]

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.[43] 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,[44] and India operates withholding at 1 per cent on certain transactions with e-commerce operators.[45]

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.

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.

41 Section 165(1), FA 2016.

42 100,000 rupees with respect to the Advertising Levy (Sections 165(2) and 166, FA 2016) and consideration equalling 10 million rupees with respect to the General Levy (Section 194-O Income Tax Act 1961).

43 Practice Note No. 1/2018, Tax Treatment on Digital Advertising Provided by a Non-Resident.

44 Section 152, Pakistan's Income Tax Ordinance 2001.

45 https://home.kpmg/us/en/home/insights/2020/10/tnf-india-tax-withholding-at-rate-of-1-percent-on-transactions-with-e-commerce-operators.html.

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.[46]

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'.[47] 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.[48] Romania, for example, stated that it would seek to renegotiate its treaties on this basis[49] 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.[50]

In its 2019 Finance Act, Nigeria expanded its tax nexus by introducing the concept of a 'significant economic presence'. Guidance recently issued by the Nigerian Ministry of Finance regarding the scope of this term confirmed that a foreign company would have a 'significant economic presence' in Nigeria if: (1) it derives annual gross turnover of more than 25 million naira from certain digital services relating to Nigeria; (2) uses a Nigerian domain name or registers a Nigerian website address; or (3) 'has a purposeful and sustained interaction with persons in Nigeria by customising its digital page or platform to target persons in Nigeria'.[51]

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

46 www.lexology.com/library/detail.aspx?g=4101bdb6-f3a4-4b65-b61c-842e0e224bff.

47 Proposal 1: A common reform of the EU's corporate tax rules for digital services, Policy Paper.

48 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.

49 Parliament Decisions No. 68 and 69 of 23 May 2018, 'Official Gazette of Romania', No. 435.

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

51 Companies Income Tax (Significant Economic Presence) Order, 2020.

sporting or concert tickets, to cover streaming services.[52] In 2016, Pennsylvania expanded its 6 per cent sales tax to cover both streaming services and other downloadable services.[53] Other states, including Alabama,[54] Illinois,[55] Louisiana,[56] Maine[57] and West Virginia[58] have considered similar taxes.

More recently, general digital sales taxes have increased after the US Supreme Court decision of *South Dakota v. Wayfair*.[59] 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, many states have amended their tax laws to account for this change in law and some have specifically widened the scope of such taxes to target digitalised businesses. Currently, 43 of the 45 states that have sales taxes have moved to an economic taxation nexus, with only Florida and Missouri still requiring a physical nexus.[60]

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,[61] the OECD has released a number of key publications and held consultation meetings regarding digital taxation.[62] Most recently,[63] the Inclusive Framework has released reports on blueprints for its (1) Proposal under Pillar One (the Pillar One Blueprint)); and (2) Global Anti-Base Erosion Proposal under Pillar Two (the Pillar Two Blueprint), as well as an economic assessment of, and request for public comments on, each Blueprint. The Pillar Two Blueprint envisages,

52 Amusement Tax Ruling #5, Electronically Delivered Amusements, Chicago Dep't of Fin. (9 June 2015).

53 Pennsylvania's Act 84 of 2016.

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

55 Illinois' House Bill 3359.

56 Louisiana's House Bill 655.

57 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.

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

59 138 S.Ct. 2080.

60 www.accountingtoday.com/opinion/coronavirus-and-wayfair-at-2-the-perfect-storm-for-online-retailers. Note, however, that there are calls in Missouri to move to an economic nexus in part to address budget holes caused by covid-19 (https://themissouritimes.com/next-steps-wayfair-sales-tax/).

61 Final Report, Paragraph 361.

62 For further details, see Pillar One Blueprint, Paragraphs 1–5.

63 At time of writing.

inter alia, an income inclusion rule[64] together with an undertaxed payments rule[65] acting as a backstop, designed to define a global minimum tax and strengthen anti-abuse provisions in a post-BEPS world.[66] These rules are complemented by a subject to tax rule,[67] which the OECD notes is important to a number of jurisdictions, particularly developing countries.[68] It is proposed that countries have discretion with regard to whether and to what extent they implement these rules. While the GloBE Proposal is likely to play an important role in any international digital taxation regime adopted,[69] we will focus on the Pillar One Blueprint and the interactions between, and cross-influences seen in, the updated proposal and DSTs.

Pillar One Blueprint

The Pillar One Blueprint states an aim to adapt the international income tax system to new business models by adapting the profit allocation and nexus rules applicable to business profits.[70] The Inclusive Framework notes that proposal involves the expansion of the taxing rights of market jurisdictions where there is an active and sustained participation of a business in the economy of that jurisdiction through activities in, or remotely directed at, that jurisdiction.[71] The OECD previously identified reallocation as motivating all three proposals in its Programme of Work that defined the scope of Pillar One,[72] namely 'user participation', 'marketing intangibles' and 'significant economic presence' proposals.[73]

The OECD put forward the Unified Approach that has been further developed into the Pillar One Blueprint based on identified commonalities within the three proposals (such as a new nexus rule independent of physical presence).[74] While elements of the Unified Approach

64 'The operation of the IIR is, in some respects, based on traditional controlled foreign company (CFC) rule principles and triggers an inclusion at the level of the shareholder where the income of a controlled foreign entity is taxed at below the effective minimum tax rate.' Pillar Two Blueprint, Paragraph 9

65 'The UTPR is a secondary rule and only applies where a Constituent Entity is not already subject to an IIR. The UTPR is nevertheless a key part of the rule set as it serves as back-stop to the IIR, ensures a level playing field and addresses inversion risks that might otherwise arise.' Pillar Two Blueprint, Paragraph 10.

66 GloBE Proposal, Paragraph 5.

67 '[The STR] is a treaty-based rule that specifically targets risks to source countries posed by BEPS structures relating to intragroup payments [and possibly some other payments] that take advantage of low nominal rates of taxation in the other contracting jurisdiction (that is, the jurisdiction of the payee). It allows the source jurisdiction to impose additional taxation on certain covered payments up to the agreed minimum rate'. Pillar Two Blueprint, Paragraph 20.

68 Cover Statement by the OECD/G20 Inclusive Framework on BEPS on the Reports on the Blueprints of Pillar One and Pillar Two (the 'Cover Statement'), Pilar Two Blueprint, p. 12.

69 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.

70 Pillar One Blueprint, Paragraph 6.

71 Pillar One Blueprint, Paragraph 6.

72 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.

73 Unified Approach, Paragraph 4.

74 Unified Approach, Paragraph 13.

remain within the Pillar One Blueprint, the developed proposal now makes no reference to an Amount C[75] and contains additional focus on mechanisms to ensure tax certainty. The following is a brief overview of the proposal:

a Amount A – the 'New Taxing Right' under the Pillar One Blueprint, [76] this amount is a simplified proxy of the portion of the residual profit of a business that can reasonably be associated with the sustained and significant participation of that multinational (MNE) in the economy of a market jurisdiction:[77]
- identifying the tax base – an adjusted profit before tax (PBT) measure derived from the IFRS (or other eligible GAAP) accounts of an MNE;
- isolate the residual profit subject to reallocation, by applying a profitability threshold based on a simplifying convention, proposed as a PBT to revenue ratio;
- further dividing the remaining non-routine profits, by applying a fixed percentage to identify that allocable to market jurisdictions, to ensure that other factors (such as trade intangibles, capital and risk) continue to be remunerated and allocated residual profit; and
- apportioning this amount to each market jurisdiction that is entitled to an allocation on the basis of the new nexus rules, which look to a revenue threshold for both automated digital services (ADS) and consumer-facing businesses (CFB) (applied to revenue deemed to be sourced from a jurisdiction[78]),[79] with additional plus factors required in the case of CFB to indicate significant and sustained engagement with the market[80] – this allocation is proposed to be based on the proportion of in-scope revenues generated in the relevant jurisdiction.[81]

b Amount B – the tax due on the remuneration of baseline distribution and marketing operations in each market jurisdiction in line with the arm's-length principle (ALP).[82] This amount is intended to enhance tax certainty, and reduce tax controversy, surrounding distribution arrangements where frequent transfer pricing disputes arise.[83]

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75 Amount C was proposed to be 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 that are compensated through Amount B. Unified Approach, Paragraph 30.

76 Pillar One Blueprint, Paragraphs 496. There is an outstanding debate as to whether to use a profit-based (absolute figures) or profit-margin based (percentage of PBT to revenue) approach when applying the formula (Paragraph 497).

77 Pillar One Blueprint, Paragraph 507.

78 Pillar One Blueprint, Paragraph 407. Relevant adjustments will include: exclusion of income tax expenses, exclusion of dividend income and gains or losses in connection with shares, and expenses not deductible for Corporate Income Tax (CIT) purposes in most Inclusive Framework jurisdictions for public policy reasons (Paragraph 409).

79 Chapter 4 of the Pillar One Blueprint deals with the proposed Revenue Sourcing Rules. There are various different proposed rules to identify the location of the consumer or user of the product or service depending on the nature of the in-scope activity.

80 Pillar One Blueprint, Paragraph 192. Identified 'plus factors' could include a subsidiary or a 'fixed place of business' (e.g., a permanent establishment), with a requirement that the subsidiary or permanent establishment is carrying out activities connected to in-scope sales. A higher threshold may be determined to be a plus factor.

81 Pillar One Blueprint, Paragraph 516.

82 Pillar One Blueprint, Paragraph 686.

83 Pillar One Blueprint, Paragraph 651.

> Therefore, the Pillar One Blueprint anticipates that Amount B may be based on a return on sales, with the potential for differentiated fixed returns based on different geographic locations and/or industries of the in-scope distributors.[84]

This system, as currently outlined, will apply to automated digital services and consumer-facing businesses,[85] creates a new nexus independent of physical presence, and includes a new profit allocation rule that moves beyond the ALP.[86]

V KEY OUTSTANDING ISSUES WITHIN THE PILLAR ONE BLUEPRINT

Despite the covid-19 pandemic, the OECD and the Inclusive Framework have continued their work to develop the Pillar One Blueprint. However, while the proposal does indicate that significant work has been done in understanding the various technical issues and design variations depending on the eventual agreed approach, it appears that significant differences remain among the members of the Inclusive Framework based on their respective interests.[87] 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 significant 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.[88]

Indications of these differing attitudes can be seen in the reactions of each group of Inclusive Framework members 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,[89] and developing

84 Pillar One Blueprint, Paragraph 653.

85 This definition potentially covers a huge variety of MNEs, and a significant portion of the Pillar One Blueprint discusses the definition and uncertainties in its application. The definition looks to business models that are consumer facing rather than those that contract with consumers, applying to goods and services 'of a type commonly' sold to consumers. Therefore, it could cover models such as franchising as well as dual use intermediate products and components to the extent of sales to consumers. Applying this definition accurately may lead to significant compliance burdens for businesses where there is some doubt as to the application of the definition (Pillar One Blueprint, Paragraphs 52 – 170).

86 Pillar One Blueprint, Paragraph 512.

87 The conflicts of interest between the various stakeholders have been described as 'insurmountable' by certain commentators, see Dorey, footnote 69, at Section 1.

88 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.

89 *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.

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),[90] but others of which are organised around more easily measurable metrics than revenue, such as levies on access to social media.[91]

Moreover, the OECD has noted in the two Blueprints (and other publications released simultaneously) that the remaining differences relate to significant points concerning the design of Pillar One, including in relation to the scope of business models within Amount A and the percentage of residual profits to be allocated among market jurisdictions. A particular point that has been focused on is the suggestion by the Treasury Secretary of the United States of America that Amount A could be a 'safe harbour', into which MNEs could elect.[92] European leaders are understood to be very sceptical of this proposal,[93] and while unilateral measures may remain in force if no agreement on Pillar One is reached (a situation recently described as 'dramatic' by the German Finance Minister),[94] the Pillar One Blueprint notes that consideration is required of the implications of the safe harbour option on whether jurisdictions would commit to remove DSTs and other unliteral measures as part of the Pillar One agreement.[95]

Considering the increasing number of DSTs and other unilateral measures discussed above,[96] and given the pressure from the G20 for a solution, [97] political decisions are required, as explicitly noted by the OECD in the Pillar One Blueprint.[98] 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.[99]

VI DEPARTURE FROM THE ALP

One of the most radical aspects of the inclusion of Amount A within the Pillar one Blueprint 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'.[100]

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90 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.

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

92 Secretary Mnuchin Letter to OECD Secretary-General, 3 December 2019; Pillar One Blueprint, Paragraphs 165–169.

93 The French finance minister Bruno Le Marie described the proposal as 'not credible' (Trade Tensions Likely As OECD Fails To Get Digital Tax Deal, 2020 Law360 286-1, 13 October 2020).

94 The UK has stated it will not repeal its DST until agreement on Pillar One is reached (UK Won't Drop Digital Tax Until OECD Deal Made, Official Says, 2020 Law360 287-46, 12 October 2020). Scholz Warns Of 'Dramatic Situation' If No Digital Tax Deal, 2020 Law360 310-37, 5 November 2020.

95 Pillar One Blueprint, Paragraph 848.

96 These are exerting 'heavy pressure', see Liu, footnote 88, at Sections 1 and 2.

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

98 Pillar One Blueprint, Paragraph 8.

99 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.

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

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.[101]

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.[102]

VII UNCERTAINTIES

Previously, the authors suggested the melding of all three proposals under Pillar One within the Unified Approach could be seen as an attempt to provide a 'pragmatic fudge',[103] 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.[104] However, it is notable that the OECD explicitly states in the Pillar One Blueprint that political decisions on the outstanding issues are required, and it is unclear whether the remaining differences on key aspects of Pillar One (including its scope) can be reached.[105] 2021 may see an intensification of the debate over whether the two Pillars should be delinked principally to expedite an agreement on Pillar Two, yet another political debate among the Inclusive Framework members.[106]

Many uncertainties surround the exact design of Pillar One, as is reflected in the questions asked in the consultation paper.[107] All are of critical importance to businesses facing unprecedented uncertainties in planning their future models. However, as with prior consultations, the questions focus on the technical aspects of the proposal, rather than its merits, so there is unlikely to be any significant changes in any eventual agreement.

Key questions that remain unanswered include the participation of the US and other headquarter jurisdictions in the new system, and whether they will allow foreign tax credit

101 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.

102 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.

103 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*.

104 '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.

105 A candidate for Secretary-General of the OECD recently stated that they would 'get the Nobel Prize' if they knew how to overcome the remaining differences (Give Tax Talks 'The Time Necessary,' OECD Candidate Says, 2020 Law360 310-26, 5 November 2020).

106 Separate OECD Proposals Possible, But Politics May Interfere, 2020 Law360 310-24, 5 November 2020.

107 Public Consultation Document on the Reports on the Pillar One and Pillar Two Blueprints.

for any amounts payable under Amount A (or Pillar One more widely). The US Treasury Secretary stated in December 2019 that the US has 'serious concerns' about aspects of the OECD's work under Pillar One.[108]

Further, the Pillar One Blueprint outlines a radical rethinking of existing multilateral dispute mechanisms in an attempt to deliver tax certainty for MNEs and tax authorities alike.[109] An effective dispute mechanism is crucial to avoiding double taxation if Pillar One is adopted, and consensus on the proposed mandatory binding dispute resolution mechanism for Amount A and other disputes must be a focus of the Inclusive Framework in its work moving forward.[110]

VIII CONCLUSION

It remains to be seen what, if any, unanimity among the various stakeholders can be forged around Pillar One. 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 Pillar One 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. Pillar One 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.

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

109 Pillar One Blueprint, Section 9.

110 Pillar One Blueprint, Paragraph 19.

Appendix 1

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ISBN 978-1-83862-797-3