Digital Cooperation Organization

DIGITAL TAXATION WHITEPAPER

A Comparative study between the OECD & UN Proposals

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Digital Taxation:
A comparative study between the OECD & UN Proposals

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Digital Cooperation Organization

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Abbreviations

ADS	Automated Digital Services
BEPS	Base Erosion and Profit Shifting
CFB	Consumer Facing Business
DE	Digital Economy
DTT	Double Taxation Treaty
ETR	Effective Tax Rate
GDP	Gross Domestic Product
GLoBE	Global anti-Base Erosion
IF	Inclusive Framework (OECD / G 20 IF)
IIR	Income Inclusion Rule
IP	Intellectual Property
MNE	Multinational Enterprise
OECD	Organization for Economic Co-operation and Development
PBT	Profit Before Tax
STTR	Subject-To-Tax Rule
UN	United Nations
UN MC	UN Model Double Taxation Convention between Developed and Developing Countries
UPE	Ultimate Parent Entity

1. Introduction

In today's digital world, the foundational infrastructure of businesses has changed. It relies heavily on online communication networks that allow the generation and the exchange of a considerable amount of data instantly, which is being processed through data technology tools and used by businesses remotely. The mobility of the Digital Economy (DE) and its heavy reliance on intangibles makes it challenging to ensure that the taxation is aligned with the location where economic activities take place and where value is effectively created.

Digitalization exacerbated Base Erosion & Profit Shifting (BEPS) issues at the level of both; the market jurisdiction (the country from which income originated) and the residence jurisdiction (the home country) of the digitalized enterprise. It was at the origin of the phenomenon of so-called "stateless income."

To date, it is obvious that the international tax rules that have been in place for more than one century do no longer fit the new modern global economy and that new rules need to be designed to allow for this changing and fast-moving environment while securing transparency, fairness, and long-term sustainable economic growth. The change is profound, notable, and very fast, raising several tax challenges, both policy, and technical.

The work on tackling tax issues of digitalization has been the main area of concern and focus of the international tax community, particularly since 2013. Action 1 of BEPS Action Plan, entitled "Addressing the tax challenges of the Digital Economy," released by OECD in 2015, was specifically dedicated to addressing the so-called "Broader tax challenges" related to nexus rules (connecting links to the market jurisdiction to assert the right to tax) and profit attribution rules (rules which enable attributing a fair share of profits to the jurisdiction where nexus is established, based mainly on the analysis of functions performed, assets used and risks assumed), but failed to address them.

Some proposals were identified, but none of them were ultimately recommended. Further works have been carried out by the OECD/G20 Inclusive Framework (IF) under the lead of OECD to agree on a two-pillar solution, i.e., so-called BEPS 2.0, to tax the DE and solve any remaining BEPS issues. Other works have also been undertaken more recently by the UN aiming at attributing more taxing rights to source jurisdictions over specific "Automated Digital Services," defined as services with little human involvement from the service provider, including mainly advertising services, online search engines, social media platforms, and cloud computing services.

In this context, this study is conducted with the aim to outline the specific features, i.e., policy rationale and design rules, of both proposals, i.e., the OECD and UN proposals, and analyze the effectiveness of each proposal in better tackling and addressing the specific tax challenges of the DE, thus ensuring that multinationals pay a fair share of taxes wherever they operate.

This study consists of two main parts. The first part outlines the specific DE features and explains how they challenged the traditional international tax rules. The second part outlines the two proposals and analyzes their potential effectiveness in addressing the issue.

2. Digital Economy: Specific Features & Broader Tax Challenges

New business models changed how products and services are produced and delivered and created new ways of payments and even new currencies. This change affected almost all sectors of activities. Nowadays, for the same business, there could be a "classic" business model and a "digitalized" business model, i.e., a classic retailer and an online retailer.

New digitalized business models include mainly e-commerce, application stores, online advertising, cloud computing, participative networked platforms and online payment services.

All these models have new and standard specific features as opposed to classic business models, which include notably[1] the mobility of intangibles, users, and functions, the reliance on data and user participation, the network effects concerning user participation and possible integration and synergies, and the volatility due to low barriers to entry and fast-evolving technology.

These features are not automatically present concomitantly in the same business. Depending on the business model, some of them are more relevant than others, but they characterize digitalized businesses in general.

In the particular case of highly digitalized businesses, they have very specific features which are, in most cases, present simultaneously in any business model. These are[2]cross-jurisdictional scale without mass[3], heavy reliance on intangible assets, including intellectual property (IP)[4] , and heavy reliance on data and user participation and their synergies with IP.[5]

All these features, especially the heavy reliance on intangibles and data and the interaction of businesses with users, as well as the innovative ways to turn value into revenue under new revenue models, notably advertising-based revenues[6], digital content purchases or rentals[7], and subscription-based revenues[8], raised tax policy challenges which fall under three broad categories, i.e., Nexus, Data, and Characterization.

Nexus

In international taxation, nexus rules consist of connecting links to a specific jurisdiction that assert the right to tax. So far, nexus rules are based on physical presence.

In this digital era, digital technology allowed businesses to assign certain substantial functions to specific locations away from the market jurisdiction, thus completely interrupting any connecting links to that market jurisdiction. It is even possible, thanks to technology, to replace persons with computers in performing many substantial activities, such as the decision-making process, and conduct them away from the market jurisdiction, without even assigning staff there.

The nexus issue is exacerbated in the case where the relationship between the user/customer and the non-resident seller goes beyond the buy/sale operation, where the user/customer interacts with the seller's platforms, for example, by tagging and recommending products, and enhances as such the brand image of the seller and increases its business value to other customers in other market jurisdictions.[9]

Depending on the revenue model, this user contribution generates indirect value that the business may monetize in different ways. However, the allocation of any profit to a specific market jurisdiction remains challenging even impossible.

For example, user contributions coming from a given market jurisdiction and reflected in the value of the business can be evaluated and monetized notably in case the business is sold, whereas, in the absence of nexus, related capital gains will be taxed elsewhere.

Another specific nexus issue raised by the change in the business models due to digitalization is related to the fact that certain activities that used to be considered by DTTs as preparatory or auxiliary in traditional businesses and did not give rise to a taxable presence in source countries, i.e., delivery activities, appear to be rather significant and substantial in DE.

Data

In the digital age, a massive amount of data is gathered, stored, and used remotely. Data constitutes a primary input into the value creation process in the DE. Value creation happens when the collected data is processed, for example, to better target customers, to enhance the product or service quality, and to better understand the customer's needs, thus resulting in making better commercial decisions.

The main issue related to data is whether raw data gathered has value. Would the mere collection of data generate value, or would it have value after being processed, when it is sold, or when the whole business is sold?[10] In other words, would it be possible, for the purpose of analyzing functions, assets, and risks, to "assign an objective value to the raw data itself, distinct from the processes used to collect, analyze, and use that data"?[11]

In other words, and according to the value creation concept, value is attributed when there are functions performed, assets used, and risks assumed in the jurisdiction. In the particular case of digital data, the mere collection of this data does not require any functions to be performed, assets to be used, and related risks to be assumed in the jurisdiction from which data originated.

Let us assume that data is collected in one country using technological tools developed in a second country (assets used) and then processed (functions performed) in that second country with related risks being borne therein to target customers in the first country.

The question here is whether a portion of the seller's profits should be attributed to the first country for the mere collection of data? If yes, how would the profit be allocated between the two countries?

Characterization

The income characterization is crucial as, under DTTs, it allows the determination of which tax treatment should profits generated by digitalized businesses receive. The development of new digital products or means of delivering services creates uncertainties in relation to the proper characterization of payments made in the context of new business models.[12]

One of the issues raised by the DE is whether the income generated under the different digitalized business models should be qualified under DTT as royalties[13], fees for technical services, or business profits.

Would infrastructure-as-a-service, software-as-a-service, and platform-as-a-service[14] be qualified as services and thus the correspondent profits characterized as business profits or as rentals of space on the cloud service provider's servers and thus characterized as royalties for the rental of scientific equipment (if covered by the definition of Royalties under the relevant DTT), or as technical services?

3. OECD Proposal - BEPS 2.0: Policy Rationale & Rule Design

Considering the specificities of the DE outlined previously, it was acknowledged by the OECD/G20 IF that, in order to attribute a fair share of taxes to market jurisdictions, there is a need for a significant departure from the standard international tax rules of the last 100 years, by the design of new nexus rules that overcome the concept of physical presence and the adoption of a formulaic approach for profit attribution (Pillar One).

It was also agreed that the remaining BEPS issues, notably the race-to-the-bottom issue (continuous decreasing of corporate tax rates), need to be addressed on the same occasion (Pillar Two).

As a response to this, the IF designed a two-pillar proposal so-called BEPS 2.0.

a. Pillar One

Pillar One comprises three components, i.e., Amount A, Amount B, and a new binding and mandatory dispute prevention and resolution mechanism to secure tax certainty of Amount A.

Amount A

Amount A consists of the excess profit to be reallocated by in-scope MNEs to market jurisdictions.

In-scope MNEs are MNEs, the global turnover of which exceeds EUR 20 Billion[15] calculated using an averaging mechanism. The threshold is to be reduced to EUR 10 Billion, contingent on successful implementation, including of tax certainty on Amount A, with the relevant review beginning seven years after the agreement comes into force and the review being completed in no more than one year.[16]

Amount A is calculated as 25% of the profit in excess of 10% of revenue (i.e., profit before tax/revenue), i.e., in case the total profitability is 14%, Amount A will be equal to 1% (25% * 4%).

Amount A will be allocated to a given market jurisdiction in case the in-scope MNE earns at least:

- EUR 1 Million in revenue from that jurisdiction, in case the jurisdiction's GDP exceeds EUR 40 Billion, and
- EUR 250 000 in revenue from that jurisdiction, in case the jurisdiction's GDP is lower than EUR 40 Billion.

Revenue will be sourced to the market jurisdiction with nexus using a revenue-based allocation key.

Double taxation of profits allocated to market jurisdictions will be relieved using either the exemption or credit method.

Opting to Pillar One implies the removal of all Digital Services Taxes and other relevant similar measures with respect to all MNEs, regardless of the turnover, and committing not to introduce such measures in the future.

Under Pillar One, taxing rights on more than USD 125 billion of profit are expected to be reallocated to market jurisdictions each year.[17]

Tax certainty

Pillar One provides for a new binding and mandatory dispute prevention and resolution mechanism to secure tax certainty of Amount A. It covers all the aspects of Amount A, i.e., in-scope MNEs, methodology of Amount A calculation and allocation, and elimination of double taxation.

It is an innovative tax certainty framework that creates two different types of panels, i.e., a review panel to conduct prior reviews of all the aspects of Amount A and a determination panel in case the review panel fails to reach an agreement.

An elective binding dispute resolution mechanism will be available only for issues related to Amount A for developing economies that are eligible for the deferral of their Peer Review according to the conditions set under Action 14 of BEPS Action Plan and have no or low levels of mutual agreement procedure disputes[18].

Amount B

Pillar One provides for the application of a fixed return for certain baseline marketing and distribution activities that is intended to be consistent with the current transfer pricing standard, i.e., the arm's length principle, and simplified and streamlined, with a particular focus on the needs of low-capacity countries.

b. Pillar Two

Pillar Two is designed to address the remaining BEPS challenges:

- One challenge is to stop the "race-to-the-bottom" and level the playing field by ensuring that large MNEs pay a minimum level of tax globally. Pillar Two puts a floor on competition over corporate income tax by introducing a global minimum effective tax rate (ETR) of 15%. The mechanism used for this purpose is called GLoBE Rules.
- Another challenge is protecting developing countries' tax base from BEPS payments by granting them additional taxing rights over the said payments. The mechanism used for the purpose is called the Subject-To-Tax-Rule (STTR).

GLoBE Rules

GLoBE Rules are based on the rationale that jurisdictions are sovereign and free to determine their tax systems, including whether they have a corporate income tax and the level of their tax rates. However, it is also acknowledged that other jurisdictions should have the right to "tax back" where the first jurisdictions have not exercised their primary taxing rights, or where the payment is otherwise subject to low levels of effective taxation.[19]

GLoBE Rules apply to each MNE separately, and the ETR of 15% is assessed on a jurisdictional basis.

Indeed, for a given MNE, in case the jurisdictional ETR is less than 15%, then a top-up tax will be due in another jurisdiction which is to be determined according to a top-down approach under the Income Inclusion Rule (IIR)[20]. According to this approach, the top-up tax is due primarily in the UPE's jurisdiction. However, if the UPE did not opt for IIR, then the next intermediate holding company in the ownership chain calculates and pays its residence state the top-up tax in respect of its low-taxed subsidiaries.

GLoBE Rules also provide for the possibility for a low-tax jurisdiction with an ETR below 15% to implement the so-called "Qualified domestic top-up tax" to capture any top-up tax that would otherwise be paid by the MNE elsewhere.

GLoBE Rules apply to MNEs the global turnover of which exceeds EUR 750 Million. They provide for certain exclusions from the scope[21]. They also provide for certain substance carve-outs[22] for in-scope MNEs to secure efficient and non-abusive tax incentives, as well as a de minimis exclusion for the sake of simplicity.[23]

The global minimum ETR is expected to generate around USD 150 Billion in additional global tax revenues annually.

STTR

STTR targets cross-border intragroup payments[24] that exploit specific provisions of the DTTs to shift profits from developing source countries to jurisdictions where those payments are subject to no or low rates of nominal taxation. STTR adopts a transactional approach. No turnover threshold is required.

STTR is based on the rationale that a source jurisdiction that has ceded taxing rights in the context of a DTT should be able to apply a top-up tax to an agreed minimum rate of 9%, where, as a result of BEPS structures relating to intragroup payments, the income that benefits from treaty protection is not taxed or is taxed at a rate lower than the minimum rate of 9% in the other contracting jurisdiction.[25]

STTR aims to restore taxing rights to the source state. It is designed to help developing source countries protect their tax base, notably those with lower administrative capacities.

It applies to developing countries with a GNI per capita less than the one calculated using the World Bank Atlas Method, which amounts to USD 12,535 in 2019. This threshold is to be regularly updated.

IF members recognize that the STTR is an integral part of achieving a consensus on Pillar Two for developing countries.

4. UN Proposal: Policy Rationale & Rule Design

In 2021, the UN Committee of Experts on International Cooperation in Tax Matters added a new article, i.e., Article (12B), to the UN MC that would grant additional taxing rights over specific "Automated Digital Services" (ADS) to source countries, i.e., countries where the customers of a non-resident service provider are located.

ADS are defined as services with little human involvement from the service provider, i.e., the user can obtain the service automatically thanks to and through IT infrastructure, where almost everything is programmed, without needing interaction with the service provider himself. The systems ultimately end up providing the service.

According to the UN Commentary of Article 12B, "An important indicator of the "automated" concept is whether there is ability to scale up and provide the same type of service to new users with minimal human involvement. In other words, once the service offering of an automated digital business is developed (such as music catalogue or social media platform), then the business can provide that service to one user, or to many more, on an automated basis with the same basic business processes".[26]

ADS include essentially[27]online advertising services[28], supply of user data[29], online search engines[30], online intermediation platform services[31], social media platforms[32], digital content services[33], online gaming[34], cloud computing services[35] , and standardized online teaching services[36].

The UN MC also provides for a negative list, i.e., services that cannot be considered as ADS, as follows: customized professional services[37], customized online teaching services[38], services providing access to the Internet or an electronic network[39], online sale of goods and services other than automated digital services[40] and revenues from the sale of physical goods irrespective of network connectivity[41].

The definition of ADS does not include payments for royalties and technical services, which remain regulated in Article 12A of UN MC.

Article 12B for ADS is designed to be adopted in DTTs if agreed between the Contracting States. It attributes a primary taxing right to source states from where the payment for ADS originates despite the fact that the place of effective use and enjoyment of ADS could be in another jurisdiction.

The primary taxing right allocated to source states is to be exercised through a withholding tax mechanism.

The withholding tax can be applied on the gross amount of the payment.

In this respect, the UN MC points out the crucial need for the withholding tax rate to be carefully negotiated with the treaty partner. Indeed, a high withholding tax rate might cause non-resident service providers to pass on the tax cost to customers in the source state. Also, a withholding tax rate higher than the foreign tax credit granted in the service provider's residence state might deter trades in the source state. Besides, some non-resident service providers may incur high costs in providing ADS, so a high rate of withholding tax on the gross payment may result in an excessive effective tax rate on the net income derived from ADS.

For these reasons, the UN MC recommends a maximum gross withholding tax rate of 3% or 4%.

Alternatively, non-resident ADS service providers can elect for a net approach of taxation which implies the application of the domestic tax rate of the source state to the "qualified profits" earned annually by the non-resident ADS service provider.

The qualified earnings shall be 30% of the amount resulting from applying the profitability ratio of the service provider's ADS segment to the gross annual revenue from ADS derived from the source state.[42]

Under DTTs, the ADS service provider will be entitled to a tax credit for the withholding tax applied in the source state, same as for royalties and technical services under Article 12A.

Recently, it was announced that the UN Tax Committee is considering implementing Article 12B using a multilateral instrument to allow the Contracting States to immediately incorporate it into existing DTTs.

5. Our opinion

a. OECD Proposal

Each of the two pillars of the OCED proposal has certain advantages that are worth stating but also has certain limits that need to be pointed out to enable further developments.

Regarding Pillar One, we consider it has the main advantage of not ring-fencing the DE. The fact that the scope includes ADS and Consumer-Facing Businesses (CFBs) is a valuable proposition and sustainable solution as the economy is becoming digital.

However, in our opinion, Pillar One has the following limits:

First, the threshold for in-scope MNEs, i.e., EUR 20 Billion, is excessively high in comparison with the threshold initially considered under Pillar One Blueprint in 2020 (EUR 750 Million, i.e., 26 times) and considerably narrows the scope and reduces the amount of residual profits to be reallocated to market jurisdictions.

Second, the eight-year period before this threshold is lowered to EUR 10 Billion is relatively long, especially that IF members are constrained to immediately abolish any other method of taxation.

Third, the new nexus revenue threshold of EUR 1 Million for jurisdictions with a GDP exceeding EUR 40 Billion is considerably high, as this GDP threshold leaves only few low-income jurisdictions in the IF below the threshold, which means that the EUR 1 Million threshold will be required in the quasi majority of the cases.

Fourth, the new nexus revenue threshold of EUR 1 Million for jurisdictions with GDP exceeding EUR 40 Billion is considerably high in the specific case of economies relying on oil and gas, where the threshold is reached thanks to oil and gas proceeds, whereas the market for in-scope MNEs is relatively small, and where there is no or low likelihood that these MNEs will reach the EUR 1 Million revenue threshold.

Fifth, the gap between the two revenue thresholds, i.e., EUR 1 Million and EUR 250,000, required to allocate residual profits to market jurisdictions depending on whether the GDP reaches or not EUR 40 Billion, is relatively large, i.e., four times, and may result in having two economies of almost the same size, one slightly above the line and one slightly under the line, but the materiality threshold for the first is four times the materiality threshold for the second.

Sixth, IF members are required to abolish immediately and commit not to implement any unilateral measures of taxation for all MNEs, including those below the threshold, which is excessive. Would it be fairer to abolish unilateral measures gradually as the turnover threshold for in-scope MNEs gradually decreases?

Seventh, tax administrations of market jurisdictions would not be able to assess or assess with accuracy whether the revenue threshold was reached or not, especially in the case where there is no physical presence. They will rely entirely on disclosures made by in-scope MNEs. For this purpose, special care needs to be given to the tax certainty of Amount A. Certain questions of key concern for market jurisdictions remain with no answer in the consultation documents released in June, related notably to who would sit on the review and determination panels, as well as how will decisions of the panels be enforced?

Regarding Pillar Two, we consider that it has the merit of stopping the race-to-the bottom and leveling the playing field as well as attributing additional taxing rights over certain payments to developing countries under STTR.

However, we do believe that there is room for certain developments.

Indeed, leveling the playing field by eliminating competition based on taxation requires, for jurisdictions to preserve their attractiveness of foreign investments, to conduct reforms that could be deep in certain cases, in order to identify and introduce or redesign non-tax incentives, which would require quite considerable time and effort to be designed, enacted and tested.

Also, the STTR would be very challenging in practice for developing countries and could not generate the expected tax revenues. Indeed, it is already difficult for developing countries to identify in practice BEPS payments, and it would be more complex after the implementation of STTR in DTTs, as new tax planning schemes are expected to be designed. New restructuring operations are expected to be conducted by MNEs as a response to STTR, especially since no tax relief is granted by the state of residence of the recipient of the payment in respect of the STTR top-up tax.

In general, the overall level of complexity of Pillar Two is very high, especially for low-capacity administrations.

b. UN Proposal

The UN proposal has, in turn, some advantages and disadvantages.

In our opinion, the main advantages of the proposal are the following:

First, the UN proposal is simple and easily administrable. It is not burdensome to the taxpayer and the administration and could thus constitute a good start and a solid basis for a sustainable solution.

Indeed, it builds on established foundations in that it provides for a withholding tax mechanism already applied for interests, royalties, and technical services under many DTTs, and, thus, requires no significant changes to DTTs' articles.

Second, it allows the possibility of applying the withholding tax on a gross basis at a low rate or a net basis, whichever is considered more convenient by the treaty partners, to avoid excessive taxation.

Third, it guarantees double tax relief under existing mechanisms provided for by DTTs and does not require the design of new dispute resolution mechanisms, especially when the withholding tax is based on gross amounts.

Fourth, it secures stable revenues to source countries "as it is not based on the profitability of an entity per se either being in a profit or loss position."[43]

Fifth, it seeks to establish multilateral cooperation by working on implementing the proposal via a multilateral instrument.

Sixth, it offers an alternative to developing countries in case the OECD Pillar One would not be seen as attributing a fair share of taxation over the profits of MNEs originating from their markets.

On the other hand, one can argue that the proposal has the following limits:

First, it ring-fences ADS and keeps CFBs out of its scope. Indeed, in the digital world nowadays, it is not possible or practical to ring-fence the DE and clearly identify a dividing line between digital and non-digital businesses to apply a specific set of tax rules. This would result in uncertainty and difficulty identifying boundaries, especially since the DE is evolving rapidly. The classification of ADS or non-ADS will become more challenging as the DE evolves.

Second, it does not cover the full extent of the issue, meaning that it is limited to B2B transactions only since it relies on a withholding tax mechanism to collect taxes. As a result, there will still be a need to design other taxation

methods to cover B2C transactions, as several ADS service providers operate in the B2C space, such as Netflix, Air BnB, Uber, and Amazon. Otherwise, potential tax revenues for ADS in the B2C space will be forgone.

Third, the sourcing rules under the proposal are quite weak. Indeed, the primary taxing right is attributed to the source jurisdiction of the payer, which does not necessarily coincide with the market jurisdiction, whereas the volatility of functions and assets which characterizes digital businesses resulted in many triangular cases where the state from which the payment is originated and the state where the service is used or enjoyed rarely coincide in many cases, but the UN proposal does not address this issue.

Fourth, the revenue computation rules under the net taxation approach are underdeveloped. Indeed, the commentary of Article 12B does not explain how the 30% rate was determined. Also, it does not provide detailed guidance about notably the computation of the profit before tax and potential segmentation and adjustments, the treatment of tax losses, etc.

Fifth, the net taxation approach constitutes a departure from the arm's length principle, but no specific dispute resolution rules were designed for this purpose. Such departure from the current transfer pricing rules would require significant technical details to ensure the formula works consistently with the current rules and does not increase tax disputes and double taxation.[44]

Sixth, potential interpretation issues might arise concerning the definition and classification of the services in the case of bundled services and packages, including ADS and non-ADS, simultaneously.

Seventh, the likelihood of this proposal being implemented by developed countries is low, which makes it non-efficient in practice.

c. OECD VS UN proposals

Both proposals present some fundamental commonalities.

They both aim at eliminating non-double taxation exacerbated by the DE.

Also, they both recognize the crucial role of market jurisdictions in generating income for MNEs from the mere collection of data originated and collected remotely from the said jurisdictions, and thus, they both overcome the concept of physical presence as a nexus for taxation and the concept of value creation as a basis for profit attribution.

However, they differ in substance in several key features.

Indeed, OECD Pillar One scope is more comprehensive in terms of the nature of businesses it targets. Indeed, it includes both ADS and CFBs, whereas the UN proposal ring-fences the DE by targeting only ADS provided by highly digitalized businesses.

Also, Pillar One targets the income generated by in-scope MNEs from B2B and B2C transactions but sets very high thresholds that considerably narrow the scope and lower the expected tax revenues to be allocated to market jurisdictions. In contrast, the UN proposal limits the taxation to B2B transactions but applies on a transactional basis without setting any threshold regarding the transaction amount.

As a conclusion, OECD Pillar One constitutes a good proposal from a technical perspective as it is based on a net approach of taxation, it does not ring-fence the DE, it covers income from B2B and B2C transactions, and it allows an effective attribution of income to market jurisdictions even in case of triangular cases.

However, the excessively high thresholds raise serious concerns about its effectiveness in achieving fairness in reallocating taxing rights, as initially aimed at and expected.

The UN proposal seems to be better adapted to developing countries and can be further developed and tailored to better respond to the specific concerns of the said countries.

In brief, the OECD proposal is ambitious but raises serious concerns about its successful implementation and consistency, whereas the UN proposal is "simpler, more practical and easier to administer, but does not cover the full extent of the issue."[45]

6. Our recommendations

Addressing the DE's tax issues requires close and effective collaboration and enhanced inclusiveness to reach an unfailing global consensus where the concerns of each country are integrated and treated on equal footing.

To date, two main proposals are being debated in the international tax community, i.e., the OECD/G20 IF Proposal, so-called BEPS 2.0, and the UN Proposal. Both proposals work on designing a multilateral solution to be endorsed by a global consensus.

Concerning the IF work on BEPS 2.0, the work done so far by the IF is a significant and remarkable step towards reframing the international tax regime.

However, certain IF members, notably low-and medium-income countries (LMICs), expressed deep concerns about what they consider as "inequities embedded in the deal,"[46], related mainly to the high thresholds under Pillar One, as well as the potentially harmful effect of the global minimum taxation on their tax incentives.

Going forward, as the signing ceremony of the deal was rescheduled to 2024, we believe it is an excellent opportunity for the IF to "reframe the deal as an initial draft and commit to working with all the members to revamp key sections and address LMICs concerns over the next few years."[47]

In the same vein, we highly recommend engaging in broader multilateral conversations and conducting in-depth studies on the intersection of tax policy and foreign direct investment policy, as well as the impact on economic recovery and poverty reduction. The tax reform would, as such, reach its objective of achieving fairness in taxation and reducing inequities.

Regarding the UN proposal, it is seen by a large number of IF members, developing countries, as a serious alternative to OECD Pillar One, being more adapted to their capacities and better serving their interests.

This position is strengthened by the support of the IMF[48] and the World Bank[49] of the UN proposal from a developing country perspective.

As a conclusion, the primary recommendation for both working groups, i.e., the IF and the UN Tax Committee, is to open the dialogue to all stakeholders by calling for an informed public debate where governments, businesses, professionals, academia, and civil society come together and discuss and interrogate openly, as part of a transparent and inclusive process, the terms of each of the deals and weigh up the advantages and drawbacks of each of them.

Failing that would result in the spread implementation of unilateral measures with a potential negative impact on international trade.

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13) July 2021: Statement on a Two–Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy

14) October 2021: Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy

15) December 2021: Global Anti-Base Erosion Model Rules (Pillar Two)

16) Early 2022: Public consultations on the implementation aspects of Pillar One and Pillar Two

17) A New Framework for Digital Taxation, Reuven Avi-Yonah, * Young Ran (Christine) Kim, † and Karen Sam (2022) A New Framework for Digital Taxation by Reuven S. Avi-Yonah, Young Ran (Christine) Kim, Karen Sam :: SSRN

18) Tax justice network, Submission to public consultation: Pillar One Amount A: Draft Model Rules for Nexus and Revenue Sourcing (2022)

19) UN Committee of Experts on International Cooperation in Tax Matters, Twenty-second Session, Tax consequences of the digitalized economy – issues of relevance for developing countries 22nd session (2021) 22nd Session of the Committee of Experts on International Cooperation in Tax Matters | Financing for Sustainable Development Office (un.org)

20) The UN Proposal on Automated Digital Services: Is It in the Interest of Developing Countries? - Kluwer International Tax Blog (kluwertaxblog.com) Vikram Chand (Managing Editor) (Tax Policy Center of the University of Lausanne, Switzerland) and Camille Vilaseca (University of Lausanne)/March 5, 2021

21) OECD: Tax certainty aspects of Amount A - KPMG United States (home.kpmg)

22) https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2021-02/IMF%20staff%20observations%20on%20proposed%20UN%20Art%2012B_0.pdf

23) 2020_1_19_WB staff comments on UN Article 12B_FINAL.pdf

24) Article-12B-of-the-UN-Model-2021-A-Simplified-Solution-for-Developing-Countries-to-Tax-Income-from-the-Digital-Economy, John W. Mpoha

[1] OECD, BEPS Action 1: "Addressing the tax challenges of the Digital Economy", para 151

[2] OECD (2019), "Tax and Digitalization - Box 2", OECD Going Digital Policy Note, OECD, Paris

[3] Cross-jurisdictional scale without mass means that digitalization has allowed businesses in many sectors to locate various stages of their production processes across different countries, and at the same time access a greater number of customers around the globe.

[4] Digitalized enterprises are characterized by the growing importance of investment in intangibles, especially intellectual property assets which could either be owned by the business or leased from a third party. For many digitalized enterprises, the intense use of intellectual property assets such as software and algorithms supporting their online platforms, websites and many other crucial functions are central to their business models.

[5] Data, user participation, network effects and the provision of user-generated content are commonly observed in the business models of more highly digitalized businesses. The benefits from data analysis are also likely to increase with the amount of collected information linked to a specific user or customer".

[6] One version of this model offers free or discounted digital content to users in exchange for requiring viewing of paid-for advertisements. Other models rely on providing advertising through mobile devices based on location or other factors. A third type concerns social media websites or platforms who typically build up a large online user community before monetizing their captive audience through advertising opportunities.

[7] Users pay per item of download - for instance, e-books, videos, apps, games and music would fall into this category.

[8] Examples include annual payments for "premium delivery" with online retailers, monthly payments for digital content including news, music, video streaming, etc. It could also include regular payments for software services and maintenance such as anti-virus software, data storage, customer "help" services for operating systems, and payment for access to the Internet itself."

[9] OECD, BEPS Action 1: "Addressing the tax challenges of the Digital Economy", para 256 : For example, in the case of a retail business operated via a website that provides a platform for customers to review and tag products, the interactions of those customers with the website can increase the value of the website to other customers, by enabling them to make more informed choices about products and to find products more relevant to their interests

[10] OECD, BEPS Action 1: "Addressing the tax challenges of the Digital Economy", para 262: "The issue of valuing data as an asset is further complicated by existing legal questions about the ownership of personal data, and the ability of users to control whether businesses can access and utilize user data by using digital services anonymously, or by deleting data stored in local caches. Many jurisdictions have passed data protection and privacy legislation to ensure that the personal data of consumers is closely protected. Under most such legislation, this information is considered to be the property of the individual from which it is derived, rather than an asset owned by a company or a public good. Economic literature analyzing intangibles, in contrast, has tended to embrace modern business realities and value also assets whose ownership may not be protected by legal rules (Corrado et al., 2012)."

[11] OECD, BEPS Action 1: "Addressing the tax challenges of the Digital Economy", para 263

[12] Supra, para 248

[13] The development of new digital products or means of delivering services creates uncertainties in relation to the proper characterization of payments made in the context of new business models, particularly in relation to cloud computing".

[14] OECD, BEPS Action 1: "Addressing the tax challenges of the Digital Economy" para 143: "The most common examples of cloud computing service models are:

• Infrastructure-as-a-service: In the most basic cloud-service model, providers of infrastructure as a service (IaaS) offer computers – physical or (more often) virtual machines – and other fundamental computing resources. IaaS clouds often offer additional resources such as a virtual-machine disk image library, raw (block) and file-based storage, firewalls, load balancers, Internet Protocol (IP) addresses, virtual local area networks (VLANs), and software bundles. The customer does not manage or control the underlying cloud infrastructure, but has control over the operating system, storage, and deployed applications, and may be given limited control of select networking components (e.g. host firewalls).

• Platform-as-a-service: Platform as a service is a category of cloud computing services that provides a computing platform and programming tools as a service for software developers. Software resources provided by the platform are embedded in the code of software applications meant to be used by end users. The client does not control or manage the underlying cloud infrastructure, including the network, servers, operating systems, or storage, but has control over the deployed applications.

• Software-as-a-service: A common form of cloud computing in which a provider allows the user to access an application from various devices through a client interface such as a web browser (e.g. web-based email). It can be provided either to business customers (B2B) or individual customers (B2C). Unlike in the old software vendor models, the code is executed remotely on the servers, thereby freeing the user of the necessity to upgrade when a new version is available – the executed version is always the latest, which means that new features go instantaneously to market without friction. The consumer generally does not manage or control the underlying cloud infrastructure, including the network, servers, operating systems, storage, or individual application capabilities, with possible exception of limited user-specific application configuration settings".

[15] Extractives and Regulated Financial Services are excluded.

[16] Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy – 8 October 2021

[17] Supra

[18] Supra

[19] Tax Challenges arising from Digitalization – Report on Pillar Two Blueprint

[20] IIR is the primary rule. Another rule, i.e. the Under-Taxed Payment Rule (UTPR), acts as a backstop to IIR, i.e. where a jurisdiction does not opt to apply IIR, the UTPR denies the deduction of certain payments up to the amount of the due top-up tax, to the extent the low tax income of a constituent entity is not subject to tax under an IIR.

[21] Government entities, international organizations, non-profit organizations, pension funds or investment funds that are Ultimate Parent Entities (UPE) of an MNE Group or any holding vehicles used by such entities, organizations or funds are not subject to the GloBE rules.

[22] The GloBE rules will provide for a formulaic substance carve-out that will exclude an amount of income that is 5% of the carrying value of tangible assets and payroll. In a transition period of 10 years, the amount of income excluded will be 8% of the carrying value of tangible assets and 10% of payroll, declining annually by 0.2 percentage points for the first five years, and by 0.4 percentage points for tangible assets and by 0.8 percentage points for payroll for the last five years.

[23] The GloBE rules will also provide for a de minimis exclusion for those jurisdictions where the MNE has revenues of less than EUR 10 million and profits of less than EUR 1 million.

[24] Royalties; Interests; Franchise fees or other payments for the use of or the right to use intangibles in combination with services; Insurance or reinsurance premiums; Guarantee, brokerage or financing fees; Rents or other payments for the use of or the right to use moveable property; Amounts paid to or retained by the payee that is consideration for the supply of marketing, procurement, agency or other intermediary services.

[25] Tax Challenges Arising from Digitalization – Report on Pillar II Blueprint.

[26] UN MC Commentary of Article 12B.

[27] Supra

[28] Online advertising services are understood as online services aimed at placing advertisements on a digital interface, including services for the purchase, storage and distribution of advertising messages, and for monitoring of advertising and measurement of its performance.

[29] The supply of user data means the provision of data to a third-party customer in respect of users of a digital interface, which is collected, compiled, aggregated or otherwise processed into data through an automated algorithm. Data in respect of users here refers to all directly or indirectly identifiable personal data, such as a user's habits, spending, location, environment, usage of services, hobbies, or personal interests or preferences, including anonymized and aggregated data (such as geo-location information and user traffic levels).

[30] Online search engines imply making a digital interface available to users for the purpose of allowing them to search across the Internet for webpages or information hosted on digital interfaces. Many online search engines are monetized through online advertising services and/or services transmitting data about users.

[31] Online intermediation platform services involve a digital interface available to users for the purpose of enabling interaction among themselves, including for the sale, hire, advertisement, display or other offer by users of particular goods, services, user-generated content or other property to other users. It does not include the online sale of goods and services of the platform's own inventory.

[32] Social media platforms involve making a platform available on a digital interface to facilitate the interaction between users or between users and user-generated content. This category includes a range of activities such as social and professional networking websites, micro-blogging platforms, video or image sharing platforms, online dating websites, platforms dedicated to sharing user reviews, as well as online call and messaging platforms, some of which could overlap with online intermediation platforms.

[33] Digital content services imply the automated provision of content in digital form, such as computer programs, applications, music, videos, books, other texts, games, online, newspapers, online libraries, online databases and software, in each case other than the data

represented by a digital interface, whether by way of online streaming, accessing or downloading digital content, whether for access one time, for a limited period or in perpetuity.

[34] Online gaming means making a digital interface available for the purposes of allowing users to interact with one another in the same game environment. This category applies to all multiplayer gaming enabled by the Internet, such as massively multiplayer online games, or other games that enable multiplayer functionalities, and regardless of the device or platform through which the game is accessed.

[35] Cloud computing services are those providing standardized on-demand network access to information technology resources, including infrastructure as a service, platforms as a service, or software as a service (such as computing services, storage services, database services, migration services, networking and content delivery services, webhosting, and end-user applications and software).The network access to on-demand standardized information technology resources includes all types of standardized cloud computing services, including computing services, storage services, database services, migration services, networking and content delivery services, webhosting, and end-user applications and software.

[36] Standardized online teaching services are those involving the provision of an online education program provided to an unlimited number of users, which does not require: (a) the live presence of an instructor; or (b) significant customization on behalf of an instructor to a particular user or limited group of users, whether with respect to the curriculum, teaching materials, or feedback provided. This category includes pre-packaged, non-customized education products such as a pre-recorded series of lectures, the content of which is not customized to each individual user (e.g. massive open online courses).

[37] Services whether provided individually or as a firm, such as legal, accounting, architecture, engineering, medical professional or financial or other specialized expert consultancy services. Although such services may be delivered online (e.g. legal advice sent by email, an architect sending drawings; or an accountant sending calculations in a spreadsheet), they require customization to each client, through the tailored exercise of professional judgment and bespoke interactions.

[38] Live or recorded teaching services delivered online, where the teacher customizes the service (such as by providing individualized, non-automated feedback and support) to the needs of a student or a limited group of students and the Internet or another electronic network is used as a tool simply for communication between the teacher and the student

[39] Provision of access (i.e. connection, subscription, installation) to the Internet or another electronic network, irrespective of the delivery method, namely over wire, lines, cable, fiber optics, satellite transmission or other means, although there may be change in situation as technology advances

[40] Sale of a good or service completed through a digital interface where: the digital interface is operated by the provider of the good or service; the main substance of the transaction is the provision of the good or service; and the good or service does not otherwise qualify as an automated digital service. This category applies to sellers that use a digital platform to sell their own non-digital goods and services to customers. While the sale can be transacted over the Internet, these businesses are sellers of non-digital goods and non-digital services, rather than offering a digital service per se

[41] Increasingly, physical goods may be connected to the Internet, or bundled with an online service. Beyond the sale of the physical good, such goods can be additionally monetized with a customer beyond the purchase of the physical good through different payment streams (whether at the outset at the time of purchase or at a later date), and those payment streams are captured by existing categories of ADS. In case no connectivity exists, then the payment for the sale of this good on internet is not an ADS.

[42] Article 12B, paragraph 3

[43] Article-12B-of-the-UN-Model-2021-A-Simplified-Solution-for-Developing-Countries-to-Tax-Income-from-the-Digital-Economy, John W. Mpoha

[44] The UN Proposal on Automated Digital Services: Is It in the Interest of Developing Countries? - Kluwer International Tax Blog (kluwertaxblog.com) Vikram Chand (Managing Editor) (Tax Policy Center of the University of Lausanne, Switzerland) and Camille Vilaseca (University of Lausanne)/March 5, 2021

[45] https://www.ciat.org/new-un-proposal-for-the-taxation-of-automated-digital-services/?lang=en

[46] The new global tax deal is bad for development (brookings.edu), Julie McCarthy

https://www.brookings.edu/blog/future-development/2022/05/16/the-new-global-tax-deal-is-bad-for-development/

[47] Supra

[48] IMF staff observations on proposed UN Art 12B_0.pdf; https://www.un.org/development/desa/financing/document/subcommittee-tax-challenges-related-digitalisation-economy-ec182018crp12

[49] 2020_1_19_WB staff comments on UN Article 12B_FINAL.pdf; https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2021-02/2020_1_19_WB%20staff%20comments%20on%20UN%20Article%2012B_FINAL.pdf