Article

Taxation of the Digital Economy: Adapting a Twentieth-Century Tax System to a Twenty-First-Century Economy

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I. INTRODUCTION

Digitalization has transformed everyday life. Routine functions are performed by using assorted digital applications and the online consumer is at the center of modern business models. Many of the world’s largest companies are highly digitalized, including Google, Amazon, Facebook, Apple, and Microsoft. The digital economy offers great benefits to society, yet its unique attributes have produced considerable tax challenges. This is primarily because highly digitalized business models often do not conform with traditional international tax characterizations. Most notably, highly digitalized businesses can earn profits in foreign economies without creating physical permanent establishments that give rise to taxing rights. As a result, significant profits remain untaxed by market jurisdictions despite the sustained involvement of highly digitalized enterprises in those market jurisdictions. International efforts are underway to address the tax challenges arising from digitalization. The OECD is working through an inclusive framework comprised of 137 countries, large and small, to achieve a long-term consensus-based solution on new taxing rights and profit allocation norms. 1 Meanwhile, as of January 2021 approximately 38 jurisdictions have announced, proposed, or already adopted unilateral measures to tax revenues from digital services provided within their jurisdictions. 2

This Article comprehensively analyzes the tax challenges arising from digitalization and the measures proposed to address them. First, the Article describes the distinct features of the digital economy and the tax challenges they present. These issues are posed by digital-tech giants that take advantage of base erosion and profit shifting mechanisms to transfer profits from high-tax to low-tax jurisdictions. Second, the Article evaluates the leading measures aimed at revising the international tax framework. These include the OECD’s Pillar One, unilateral digital services taxes, and a U.N. proposal. The Article then analyzes some of the most current developments in the digital tax debate. This includes the U.S.-France dispute over France’s Digital Tax Bill, and the future of international tax reform during the COVID-19 pandemic. Finally, the Article


args in favor of a multilateral solution, implemented on an OECD-level. This Article proposes applying the new nexus based on market thresholds and subject to a global de minimis amount, that is not dependent on physical presence. This Article advises against global revenue thresholds that discriminate against U.S.-based companies and which do not reflect economic involvement in market jurisdictions.

II. DIGITAL ECONOMY

A. A Digital Transformation

Digitalization is reinventing business models in all industries and changing the way companies engage with consumers around the world. The extensive use of computers and smartphones is a prime example of the transition to a digital world, demonstrated by the prominent consumption of social media, online marketplaces, streaming services, internet advertisements, and the like. Despite the remarkable prevalence of digital technology, the process of “digitalization,” or the concept of a “digital economy” remain terms that lack a commonly understood definition.

“Digitalization” or “digital transformation” refer to systems and effects on economic activity set forth by encoding of information into binary bits that can be interpreted by computers. According to a 2015 OECD report, “the digital economy is the result of a transformative process generated by information and communication technology.” Businesses operating in the digital economy engage with user data (e.g. placement of advertising), services connecting users to each other (e.g. online sharing platforms and marketplaces), and other digital services (e.g. streaming services). As noted by the OECD, drawing lines between what is digital and what is not can be a daunting task, “because the digital economy is increasingly becoming the economy itself.” This is particularly evident during the COVID-19 crisis in which even tangible business activity has increasingly shifted online, and classifying the digital economy becomes more difficult.

Notwithstanding some definitional ambiguities, digital technology has rapidly integrated intelligent data into everything we do, and online platforms

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4. Id.
7. OECD, supra note 5, at 54.
8. See U.N. Conference on Trade and Development, Statement by Mr. Mukhisa Kituyi, Secretary-General of UNCTAD on Covid-19 and the Digital Economy (Apr. 6, 2020) (stating that “there has been a shift to electronic commerce over physical retail and service provision”).
are increasingly powerful in the world economy. In 2017, the combined value of digital platform companies with market capitalization exceeding $100 million was estimated to be over $7 trillion, a 67% increase from 2015. Digital platforms and services have obtained momentous market positions: Google, for example, accounts for 90% of internet searches, while Facebook accounts for two-thirds of the world’s social media market, and is the top social media platform in over 90% of the world’s economies. By 2019, online retail-giant Amazon accounted for almost 40% of the world’s online retail activity. The drastic increase in online usage and data demonstrates the growth of the digital economy. In 2019, there were 4.39 billion internet users (an increase of 9% from 2018), 5.11 billion unique mobile users, and 3.48 billion social media users.

In 2018, 95% of businesses in the OECD operated with a high-speed internet connection. The global volume of online data is expected to grow from a total of 33 zettabytes in 2018 to 175 zettabytes by 2025. The value of the digital economy on a global scale is estimated to be between 4.5% to 15.5% of the world’s GDP.

The digital economy is not governed by a traditional “North-South,” “East-West,” or “developed-developing” divide. Instead, two countries—the U.S. and China—and a handful of digital platforms therefrom dominate the digital world. In 2019, the U.S. and China accounted for 90% of the market capital value of the world’s 70 largest digital platforms. In comparison, the entire share of Europe was 4%, and Latin America and Africa together accounted for only 1%. The U.S.-based Apple, Microsoft, Amazon, Google and Facebook, along with the China-based Tencent and Alibaba, comprise two thirds of this total market capitalization value. In July 2020, the world’s five largest companies by market capitalization were the aforementioned Apple, Microsoft, Amazon, Alphabet (Google), and Facebook, in relevant order. These companies alone have a market capitalization of over $6 trillion, and in 2019 reported over $800 billion

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10. Digital platform companies provide value by enabling connection, information, and data sharing by and between users. Examples include Amazon, eBay, and Alibaba.


12. Id.

13. Id.

14. Id.


16. A zettabyte is equivalent to one trillion gigabytes. See Reinsel, Gantz & Rydning, supra note 3, at 3.

17. This range depends on the classification of the “digital economy.” See UNCTAD 2019 Report, supra note 11, at xvi.

18. See id. at xvi.

19. Id.

20. Id.

21. Id.

of revenues while earning over $150 billion of profits.\textsuperscript{23} Apple and Alphabet are also among the world’s ten most profitable companies.\textsuperscript{24}

\textbf{B. Principles of International Taxation}

To understand the challenges posed by digitalization, consider some fundamental principles of international taxation. The international tax framework is founded on a broad network of bilateral income tax treaties.\textsuperscript{25} These include three notable model conventions, with which bilateral treaties generally conform: the OECD Model Tax Convention on Income and on Capital, the U.N. Model Double Taxation Convention between Developed and Developing Countries, and the U.S. Model Income Tax Convention.\textsuperscript{26} Most tax treaties adhere to the OECD Model Tax Convention.\textsuperscript{27} Income tax treaties determine when a resident enterprise of one State maintains sufficient connection to another State to justify levying taxation by the latter State.\textsuperscript{28} Under Article 5 of the OECD Model Tax Convention,\textsuperscript{29} this connection exists when an enterprise resident in one State (the residence State) has a permanent establishment (PE) in another State (the source State).\textsuperscript{30} A PE is a “fixed place of business” through which an enterprise wholly or partly carries out its business.\textsuperscript{31} This can include a place of management, branch, office, factory, workshop, or place of extraction of natural resources.\textsuperscript{32} The PE threshold can also be satisfied if a dependent agent of the foreign enterprise acts on its behalf and habitually exercises authority to conclude contracts in its name.\textsuperscript{33} A certain level of physical presence in the source jurisdiction is typically required to constitute a PE. If an enterprise does not have physical presence in the foreign jurisdiction, it does not have a PE and thus no income tax nexus arises.\textsuperscript{34} The PE standard set forth in Article 5 of the OECD Model Tax Convention is the international norm facilitating taxation of non-resident enterprises.\textsuperscript{35}


\textsuperscript{24} Id.

\textsuperscript{25} OECD, supra note 5, at 26.


\textsuperscript{29} As well as in the U.N. and U.S. Model Conventions.

\textsuperscript{30} OECD Model Tax Convention, supra note 26, at art. 5; Grinberg supra note 28, at 85.

\textsuperscript{31} OECD Model Tax Convention, supra note 26, at art. 5.

\textsuperscript{32} Id.

\textsuperscript{33} Id.


\textsuperscript{35} Grinberg, supra note 28, at 88-90.
Under this norm, the source country may tax business profits of an enterprise only if the enterprise carries out a business in that country through a PE, and those profits are attributable to that PE.\textsuperscript{36} Profits attributable to a PE are profits that the PE would be expected to make if it were a separate and independent enterprise engaging in the same or similar activities.\textsuperscript{37}

Equipment and machinery located in a particular country may constitute a fixed place of business and thus a PE in that country. A noteworthy distinction is made between computer equipment which may be set up at a certain location to constitute a PE, and the data and software used by that computer, which does not.\textsuperscript{38} An internet website, for example, is not tangible property and does not constitute a fixed place of business.\textsuperscript{39} The server on which that website is stored may constitute a fixed place of business, in the physical location in which that server is accessible through a piece of equipment.\textsuperscript{40} An enterprise is still generally required to maintain a physical presence in the source country to be subject to income tax liability. Multinational enterprises (MNEs) can thus avoid having a PE by locating servers outside of a country, regardless of the volume of digital sales into that country.\textsuperscript{41} This also enables MNEs to report profits outside of a market jurisdiction, a common practice discussed more in detail in the following section.

\textbf{C. The Tax Challenges Arising from Digitalization}

The growing digital transformation poses great international tax challenges, as current international tax law and its principles have failed to adapt to global business practices.\textsuperscript{42} An ever-rising digital economy increases the difficulty of taxing highly digitalized businesses that do not conform with traditional physical business models. The current international tax framework was designed to accommodate a traditional “brick and mortar” economy. It has not evolved to undertake modern business models in which physical presence in the source jurisdiction is unnecessary.\textsuperscript{43} Nowadays, enterprises can be heavily involved in the economic life of another country without having a fixed place of business or a dependent agent that would constitute a PE.\textsuperscript{44} This is the practice of highly digitalized businesses that engage in online activity and provide digital services to consumers worldwide with no fixed place of business in the market.

\begin{itemize}
\item \textsuperscript{36} Gianni, \textit{supra} note 34, at 259.
\item \textsuperscript{37} OECD Model Tax Convention, \textit{supra} note 26, at art. 7.
\item \textsuperscript{38} OECD, \textsc{commentaries on the articles of the model tax convention}, Commentary on Article 5, \textsection{} 42.2 (2017) [hereinafter OECD Commentaries].
\item \textsuperscript{39} Id.
\item \textsuperscript{40} Id.
\item \textsuperscript{41} Id.
\item \textsuperscript{42} According to the OECD, a server could create a PE if its functions are typically related to a sale in which case the enterprise would be taxable on income attributable to that server PE. See Monica Gianni, \textit{The OECD’s Flawed and Dated Approach to Computer Servers Creating PEs}, 17 \textit{VAND. J. ENT. & TECH. L.}, 1, 5 (2014); OECD Commentaries, \textit{supra} note 38, \textsection{} 42.2.
\item \textsuperscript{43} Louise Fjord Kjarsgaard and Peter Koever Schmidt, \textit{Allocation of the Right to Tax Income from Digital Intermediary Platforms: Challenges and Possibilities for Taxation in the Jurisdiction of the User}, 1 \textit{NORDIC J. COM. L.}, 146, 148 (2018).
\item \textsuperscript{44} Id.
\end{itemize}
jurisdiction. A digital company can offer services online, thereby reaching consumers without ever being physically present in the jurisdiction where its consumers are located.45 Absent a PE in the market, profits from digital services are taxed primarily in the residence country of the selling enterprise (i.e. country of incorporation). Highly digitized MNEs can also incorporate and stash profits in low-tax jurisdictions, while engaging in sustained commercial activity in market countries where their profits remain untaxed.

Digital business models feature unique characteristics. They generally operate online, and rely heavily on intangibles, customer-generated content, mobility, automation, and the ability to engage with consumers without a physical presence.46 Widespread examples of such activities include placement of online advertising, use of digital (internet) intermediary platforms,47 cloud computing, and sale of user-generated data. The challenge of taxing a highly digitalized enterprise that does not conform with traditional physical characteristics can be demonstrated through prominent business examples. Consider the case of Uber Technologies, Inc., a leading digital intermediary platform. Uber operates by linking drivers and passengers to complete rides,48 and charges a fee in exchange for providing its intermediary mediation service. Uber, like many other highly digitalized enterprises, benefits from low taxation of its worldwide income partly due to tax planning structures involving entities in low-tax jurisdictions.49 For many companies like Uber, this means avoiding a PE in market jurisdictions in which users are located. In Uber’s case, a Netherlands subsidiary (Uber International C.V.) processes the global payments for all rides.50 Similarly, audio streaming service Spotify maintains its operational office in Sweden, though it is headquartered in tax-friendly Luxembourg.51 Moreover, for many years most of Google’s and Facebook’s European revenues were reported in Ireland subsidiaries: Google Ireland Ltd. and Facebook Ireland Ltd., respectively.52

MNEs use several strategies to reduce their tax liability on international income. These measures, often known as Base Erosion and Profit Shifting (BEPS), include minimizing profit taxation in a source country by avoiding source country tax jurisdiction, shifting profits to tax havens, treaty shopping or

45. Gianni, supra note 34, at 285.
46. Id. at 270; OECD, supra note 5, at 86.
47. The OECD defines “internet intermediaries” as enterprises that “bring together or facilitate transactions between third parties on the Internet. They give access to, host, transmit and index content, products and services originated by third parties on the Internet or provide Internet-based services to third parties.” Examples include Uber, Airbnb, and Amazon. See Karine Perset, The Economic and Social Role of Internet Intermediaries, at 9, OECD Digital Economy Papers, No. 171 (Apr. 2010), https://www.oecd-ilibrary.org/docserver/5kmh79zzs8vb-en.pdf?expires=1610645320&id=id&accname=guest&checksum=7B856CF3334BA8F2A8FC6C3FA22708.
49. Id. at 152.
50. Id.
51. Spotify Technology S.A., SEC Amendment No. 3 to Form F-1 Registration Statement, at 7 (2018).
taking advantage of favorable treaties to minimize tax liability, and avoiding the application of Controlled Foreign Corporation rules. A heavy reliance on intangibles allows digital MNEs to avoid a physical presence in the source country and shift profits to tax havens or low tax jurisdictions with relative ease. Revenues are not necessarily reported in the countries where they were earned, which makes it more difficult for market jurisdictions to tax them. This leads to a disparity between the location of digital consumers and the location of booked revenues. The result is a double-distortion to the advantage of highly digitalized enterprises.

First, the total tax liability of global digital enterprises is lower than similarly profitable non-digital, or “traditional” enterprises. In 2017, the European Commission (EC) found that digital domestic businesses are subject to an effective average tax rate of 8.5%, whereas traditional (physical) domestic businesses are subject to an effective average tax rate of 20.9%. Similarly, digital international businesses are subject to an effective tax rate of only 10.1%, whereas traditional international businesses are subject to an effective average tax rate of 23.2%. According to the EC, this tax gap exists primarily due to digital business models which rely heavily on intangible assets and benefit from tax incentives. In July 2020, the OECD released a new corporate tax statistics report on the global tax and economic activities of nearly 4,000 MNEs headquartered in 26 jurisdictions and operating across more than 100 jurisdictions worldwide. According to the OECD, there is a misalignment between the locations where profits are reported and where economic activity occurs. In investment hubs, MNEs report on average a relatively high share of profits (25%) compared to their shares of employees (4%) and tangible assets (11%). Furthermore, the predominant business activity of MNEs in investment hubs is holding shares and other equity instruments. This indicates the existence of BEPS and tax planning structures in low-tax jurisdictions, and

54. Jinyan Li, Protecting the Tax Base in the Digital Economy, in U.N. HANDBOOK ON SELECTED ISSUES IN PROTECTING THE TAX BASE OF DEVELOPING COUNTRIES 27 (June 2014).
55. UNCTAD 2019 Report, supra note 11, at 95.
56. Id.
57. The EC is the executive branch of the European Union.
59. Id.
60. OECD, CORPORATE TAX STATISTICS 33 (2nd ed., 2020).
61. Id. at 41.
62. In the OECD report, investment hubs are defined as jurisdictions with a total inward foreign direct investment position above 150% of GDP which includes Bahamas; Barbados; Bermuda; British Virgin Islands; Cayman Islands; Cyprus; Gibraltar; Guernsey; Hong Kong; China; Hungary; Ireland; Isle of Man; Jersey; Liberia; Luxembourg; Malta; Marshall Islands; Mauritius; Mozambique; Netherlands; Singapore; and Switzerland. See id.
63. Id. at 44.
reinforces the need to address under-taxation and non-taxation of MNEs in a digital world.64

A second distortion is manifested in the imbalanced allocation of taxing rights between jurisdictions. In the present international tax framework, profits of highly digitalized MNEs are not equitably allocated to market jurisdictions where commercial activity occurs. This can be demonstrated by examining the reported earnings of Facebook Inc. and Alphabet Inc. (Google). In 2017, Facebook earned 56% of its revenues and 66% of its profits outside the U.S.65 Facebook, however, paid only 8% of its taxes to countries outside the U.S., according to the company’s 2017 annual report.66 Similarly, in 2017 Google earned 53% of its revenues and 61% of its profits outside the U.S., yet paid only 12% of its taxes to foreign countries, according to the company’s 2017 annual report.68

The lengthy operation of Google and Facebook in Ireland illustrates the ability of highly digitalized MNEs to shift profits to low-tax countries, thereby decreasing their total tax liability. In 2015, the vast majority of Google’s and Facebook’s European revenues were booked in Google Ireland Ltd. and Facebook Ireland Ltd., respectively.69 Ireland is a low-tax EU Member State, imposing a mere 12.5% corporate tax rate for trading income70 and a 6.25% rate for revenues related to a company’s patent or IP operations.71 When examining activity within EU States, studies show that in each of Spain, Italy, France, Germany and the U.K.,72 Google had over thirty million internet users, and Facebook had over twenty million accounts.73 In Ireland, meanwhile, Google had fewer than ten million internet users and Facebook had fewer than five


65. Approximately $22 billion, and $13.5 billion, respectively. See UNCTAD 2019 Report, supra note 11, at 95.


67. Approximately $58.4 billion, and $16.5 billion, respectively. See UNCTAD 2019 Report, supra note 11, at 95.


69. Tang & Bussink, supra note 52, at 3.


72. The U.K. withdrew from the EU on January 31, 2020, with a transition period until December 31, 2021. The U.K. is referred to as EU Member State because the data presented herein refers to the period prior to its withdrawal. For more on the U.K.’s withdrawal from the EU, see European Council, Decision (EU) 2020/135 on the Conclusion of the Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community, L 29/1 (Jan. 30, 2020).

73. Tang & Bussink, supra note 52, at 3.
million accounts. In 2015, Google reported over €22 billion in revenues in Ireland despite the smaller Irish consumer market. The next-closest country in terms of revenue reporting was the U.K., where Google reported fewer than €2 billion in revenues, despite having almost sixty million users there. A similar pattern can be observed in the reports of Facebook Ireland Ltd., where Facebook reported over €7 billion in revenues. The next-closest country was also the U.K., where just over €2 billion in revenues was reported, despite having almost forty million Facebook accounts.

In 2015, both Google and Facebook paid very limited taxes in Ireland. Google paid only €47.8 million in taxes on €22.6 billion of Google Ireland Ltd. revenue, according to company filings. Facebook, meanwhile, paid only €16.5 million in Ireland taxes on its €7.9 billion of Facebook Ireland Ltd. revenue. This was accomplished by taking advantage of BEPS mechanisms in order to minimize tax liability. Part of Google’s tax planning strategy, for example, involved shifting billions of euros to a Dutch subsidiary and then to a Bermuda-based company. MNEs continue to minimize taxation in market countries by avoiding a taxable presence, or in the case of a taxable presence, shifting profits to lower-tax jurisdictions through trading structures and favorable tax treaties. Using BEPS thereby results in reducing an MNE’s total tax liability as well as its tax liability in the particular markets, creating under-taxation.

III. FUNDAMENTAL QUESTIONS

The challenges of taxing the digital economy can generally be summarized by two key tax policy questions: first, how to establish taxing rights (nexus) in jurisdictions where foreign businesses have significant commercial presence with little or no physical presence and, second, how and where to allocate the taxable profits of MNEs.

Addressing these issues is not just a present-day challenge. The PE concept, which emerged in the German Empire over a century ago, has been extensively evaluated during the past decades due to changes in business methods and the development of technology. In 1978, former U.S. Assistant Secretary of Treasury Stanley Surrey recognized that technological advancements required reassessing traditional PE norms. Surrey claimed that “modern methods of business and communication” made some requirements of

74. Id. at 3-4.
75. Id. at 3.
76. Id. at 4.
79. OECD, supra note 5, at 78.
80. 2017 EC Communication, supra note 58, at 7.
the OECD Model Tax Convention obsolete.\textsuperscript{82} According to Surrey, developing countries had accepted the PE concept, yet sought to expand the PE definition and narrow the extent to which it limited source taxation. Such expansion would allocate more taxing rights to market jurisdictions and therefore benefit developing countries.\textsuperscript{83} In 1997, Reuven Avi-Yonah argued that the rise of electronic commerce presented a challenge to traditional concepts of international taxation.\textsuperscript{84} Avi-Yonah proposed expanding the PE concept with a de minimis threshold of gross income earned within the taxing jurisdiction. Once over the de minimis threshold, income from electronic commerce would be taxed in the jurisdiction where goods and services are consumed.\textsuperscript{85} In 2003, Arthur J. Cockfield proposed modifying the PE principle to account for modern commercial practices that “permit nonresident firms to generate significant revenues in foreign markets without the need for a physical presence.”\textsuperscript{86} Cockfield stated that a PE based on quantitative economic presence would be consistent with historic PE rationales and could restore a balanced sharing of tax revenues among countries.\textsuperscript{87}

Digitalization is considered further reason to promote the reform of international tax rules. Scholars have argued that the current PE definition requires structural changes to address the new business models developed in the digital economy.\textsuperscript{88} Peter Hongler and Pasquale Pistone have proposed a new PE nexus based on digital presence, which considers the number of users in a contracting State as a threshold for PE.\textsuperscript{89} Wolfgang Schöen has proposed allocating taxing rights based on investments of digital firms into a market jurisdiction.\textsuperscript{90} Andrés Báez Moreno and Yariv Brauner have argued that “tweaking” international tax rules by attempting to tax foreign MNEs in market jurisdictions would be ineffective\textsuperscript{91} and have recommended imposing a

\textsuperscript{83} Id.
\textsuperscript{84} See Reuven S. Avi-Yonah, \textit{International Taxation of Electronic Commerce}, 52 TAX L. REV. 507, 555 (1997); Professor Avi-Yonah is the Director of the International Tax LL.M. Program at Michigan Law School.
\textsuperscript{85} Id. at 510.
\textsuperscript{86} See Arthur J. Cockfield, \textit{Reforming the Permanent Establishment Principle through a Quantitative Economic Presence Test}, CAN. BUS. L.J. 400, 400 (2003); Professor Arthur J. Cockfield is a professor at Queen’s University Faculty of Law.
\textsuperscript{87} Id. at 408-410.
\textsuperscript{88} See Peter Hongler & Pasquale Pistone, \textit{Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy} 2 (Vienna University of Economics & Business, International Taxation Research Paper Series, No. 2015-15, 2015); Professor Pistone is the Academic Chairman of IBFD; Professor Hongler is a Professor of Tax Law at the University of St. Gallen.
\textsuperscript{89} Id. at 3.
\textsuperscript{90} See Wolfgang Schöen, \textit{One Answer to Why and How to Tax the Digitalized Economy} 18-24 (Max Planck Institute for Tax Law & Public Finance, Working Paper No. 2019-10, 2019); Professor Schöen is the Director of the Department of Business and Tax Law at the Max Planck Institute for Tax Law and Public Finance in Munich.
\textsuperscript{91} See Andres Báez Moreno & Yariv Brauner, \textit{Taxing the Digital Economy Post BEPS . . . Seriously} 5-7 (University of Florida Levin College of Law, Research Paper No. 19-16, 2019); Professor Báez Moreno is an Associate Professor of tax law at Universidad Carlos III in Madrid; Professor Brauner is Chair in Taxation and Professor of law at the University of Florida Levin College of Law.
withholding tax on base-eroding payments to non-residents.92

This short overview provides a mere introduction to the broad variety of scholarly perspectives on reforming international tax rules. Nonetheless, legal scholarship has generally indicated that reconsidering traditional international tax norms is necessary given modern business practices. This conclusion has resonated with much of the world, including governments and supranational organizations. As written by Itai Grinberg, “All the largest economies have come to agree either that a) there is something wrong with the taxation of the ‘digital economy,’ or b) there is something more fundamentally wrong with the structure of the current international tax system in an era of globalization and digitalization.”93 Addressing the tax challenges of digitalization has thereby been driven mostly by the world’s prominent, developed economies: the OECD and EU organizations, as well as their Member States.

IV. THE OECD PROPOSAL

A. The OECD Base Erosion and Profit Shifting Project

The tax challenges arising from digitalization have been identified as one of the main areas of focus in the OECD Base Erosion and Profit Shifting Project (BEPS Project). Through reports spanning several years and a blueprint in October 2020,94 the OECD aims to achieve a consensus-based long-term solution to address the tax challenges arising from digitalization by the middle of 2021.95

At the 2012 G20 Los Cabos summit,96 the G20 tasked the OECD with developing a BEPS Project Action Plan,97 which was later approved at the 2013 G20 St. Petersburg summit.98 A primary goal of the BEPS Project is to prevent MNEs from artificially shifting profits to low tax jurisdictions.99 The OECD recognizes the broad impact of globalization on countries’ corporate income tax regimes, and the opportunities that MNEs have to greatly minimize tax burdens in an integrated global economy.100 The use of BEPS to shift taxable profits hurts governments that need to cope with revenue losses and spend on compliance measures while their tax systems are undermined. Meanwhile, taxpayers and

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92. Id. at 7-8.
93. See Grinberg, supra note 28, at 85.
95. Id. at 9.
96. The G20 is an international forum comprising 19 countries and the EU, and representing the world’s major developed and emerging economies. Together, the G20 members represent 85 % of global GDP, 75% of international trade and two-thirds of the world’s population. For more, see About G20, OECD, https://www.oecd.org/g20/about/.
99. OECD, supra note 97, at 8.
100. Id. at 7.
domestic businesses bear a greater share of the tax burden and are at a 
competitive disadvantage versus large MNEs. Addressing the tax challenges 
of digitalization has thus been the priority and focus of the BEPS Project.

In 2015, a fifteen-point Action Plan was released by the OECD to address 
the issues presented by BEPS. Action 1 is titled “Addressing the Tax Challenges 
of the Digital Economy,” and meticulously describes the challenges, key 
features, policy concerns, and future work to be conducted on taxing the digital 
economy. Action 1 concluded that the digital economy presents key features that 
exacerbate BEPS risks. The OECD elected to continue working through an 
OECD/G20 Inclusive Framework on BEPS, and to deliver an interim report in 
2018 and a final report in 2020, later pushed to 2021. The Inclusive 
Framework is a collaboration of 137 countries on implementation of BEPS and 
international tax rules, extending far beyond OECD Member States. The 2018 
Interim Report did not advise provisional measures, and restated the commitment 
to a consensus-based solution. The OECD’s efforts substantially advanced in 
2019, when the Inclusive Framework introduced a two-pillar approach to form 
the basis for a long-term consensus. Pillar One would address the broader 
challenges of digitalization and prescribe new profit allocation and nexus rules, 
while Pillar Two would address remaining BEPS issues including a global 
minimum tax rate.

B. The OECD’s Pillar One

On October 9, 2019, the Secretariat of the OECD published a “Proposal for 
a “Unified Approach” under Pillar One,” designed to address the tax challenges 
of digitalization and grant new taxing rights to market jurisdictions. The 
proposal established a new taxing right independent of physical presence, 
applied through global and market revenue thresholds. The proposal set forth a 
new rule that would allocate a share of a foreign company’s deemed residual 
(non-routine) profits to the market jurisdiction. On October 14, 2020, the 
OECD released a “Report on Pillar One Blueprint” providing foundation for a 
future agreement on international tax reform. Pillar One consists of three main

101. Id. at 8.
102. See OECD, supra note 5.
103. Id.
104. Id. at 143.
106. OECD, supra note 94, at 9.
107. See OECD, supra note 1.
108. OECD, supra note 105, at 212.
109. OECD, Addressing the Tax Challenges of the Digitalisation of the Economy: Policy Note, 
challenges-digitalisation.pdf
110. OECD, Public Consultation Document: Secretariat Proposal for a “Unified Approach” 
proposal-unified-approach-pillar-one.pdf.
111. Id. at 5-6.
112. OECD, supra note 94 at 8.
components: a new taxing right for market jurisdictions over a portion of residual (non-routine) profits calculated at the MNE-group level; a fixed return for baseline marketing and distribution functions that physically transpire in the market jurisdiction; and dispute prevention and resolution mechanisms. The Pillar One Blueprint was opened to public consultation for stakeholder input and endorsed by the G20 with the aim of achieving a consensus-based solution by the middle of 2021.

1. Pillar One Scope

Pillar One’s scope is generally broad and includes both automated digital services and other consumer-facing businesses. Automated digital services include a non-exhaustive list of business models such as online search engines, social media platforms, online intermediation platforms (including marketplaces), digital content streaming, online gaming, cloud computing, and online advertising. Excluded activities include online sales of physical goods, customized professional services, and the provision of internet access. The category of consumer-facing businesses refers to businesses that generate revenue from goods and services commonly sold to consumers. These include a non-exhaustive list of business sectors such as automobiles, branded foods, clothes and cosmetics, mobile phones, home appliances, and computing products. Excluded from this category are financial services, natural resource extraction, construction, and international airline and shipping businesses. While the OECD has worked diligently to define these categories, it has yet to achieve a political agreement on how these categories should be used.

The goal of Pillar One is to address the tax challenges of digitalization while recognizing the difficulty of characterizing what is digital and what is not, which is a major tax policy consideration. The OECD has expressed that “because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the

113. Id. at 11.
117. Id. at 20.
118. Id.
119. Id.
120. This category relates to individuals who purchase items for personal use and not for commercial or professional purposes. This would also bring into scope those that sell consumer products through intermediaries who perform routine tasks such as packaging or assembly. See OECD, Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy, at 11 (2020), https://www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf.
121. Id.
122. OECD, supra note 94, at 49.
123. Id. at 12.
The rest of the economy for tax purposes. In an ever-digitalizing world, isolating digital businesses would indeed violate the neutrality of the tax system and require drawing arbitrary lines between the digital and non-digital fields.

2. **New Taxing Right (Amount A)**

For businesses falling within the Pillar One scope, a new taxing right (Amount A) is introduced, and applies on top of existing nexus and profit allocation rules. It will apply where a business has a sustained and significant involvement in the economy of a market jurisdiction irrespective of its physical presence in that jurisdiction. The new taxing right would be introduced as a standalone rule—on top of the PE rule—to “limit any unintended spill-over effect on other existing rules.” It would include a revenue threshold based on annual consolidated group revenue, together with a de minimis foreign in-scope revenue carve-out. This means the inclusion of a global “revenue test” threshold that would apply the new taxing right only to companies of a certain scale. This threshold would refer to the total gross revenues of an MNE, determined at the level of the company group. A secondary “de minimis foreign in-scope revenue test” would then be applied to MNEs that exceed the global threshold, yet have only small in-scope revenues. This carveout, an absolute number, would be applied to determine the MNEs in scope of Amount A. The goal is to achieve a similar result for MNEs who engage in foreign market jurisdictions to a smaller extent, regardless of whether their engagement is significantly smaller than a domestic business.

A political decision will be necessary to design and determine the global “revenue test” threshold amount. According to the Pillar One Blueprint, the global threshold ought to be at least €750 million, because a lower threshold will go beyond tax administrations’ capacity to operate the new taxing right. A €750 million amount also corresponds to the threshold for country-by-country reporting requirements under BEPS Action 13. Under this threshold, an MNE reporting under €750 million of annual revenues would not be subject to the new taxing right. Such a size-limitation would apply Pillar One only to considerably large MNEs. According to the OECD’s estimates, a €750 million global revenue

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124. OECD, *supra* note 5, at 142.
127. OECD, *supra* note 110, at 8.
128. *Id.* Because Amount A applies on top of existing profit allocation rules, it will be necessary to eliminate double taxation in the event that profits of an MNE are already allocated to the market jurisdiction under existing rules. A mechanism to eliminate double taxation will identify which of the MNE’s entities are liable for the Amount A tax and determine the methods to eliminate double taxation in their respect. See OECD, *supra* note 94, at 139.
130. *Id.* at 58.
131. *Id.* at 59.
132. *Id.* at 59-60.
133. *Id.* at 59.
threshold applies the new rule to approximately 8,000 MNEs, and only to a maximum of approximately 2,300 MNEs whose primary activities are automated digital services and consumer-faced business. The OECD proposes a solely revenue-based threshold for automated digital businesses, but would require a “plus factor” in addition to the global revenue threshold to create a taxable nexus for other consumer-facing businesses. This proposed plus factor would be an independent PE test identifying a fixed place of business through which an in-scope, consumer-facing business of the MNE is operating.

3. New Nexus and Profit Allocation Rule

Businesses falling within Pillar One’s scope will be subject to the new nexus that is based on significant and sustained engagement with the market jurisdiction. This will be indicated by a market revenue threshold applied to the in-scope revenue of an MNE that is generated in the market jurisdiction. The Pillar One Blueprint indicates that market revenue thresholds could be adjusted to the size of the market (such as by GDP), and that different thresholds could apply to automated digital services and to consumer-facing businesses. It is therefore possible to view Pillar One as creating two thresholds: a global revenue threshold at the MNE group level and a threshold for revenue generated in the market jurisdiction. Both thresholds would need to be satisfied to give rise to the new taxing right and nexus in the market jurisdiction. A set of revenue sourcing principles would be established to determine the revenues considered to be derived from a particular market jurisdiction.

Pillar One would also include a new profit allocation norm that allocates a portion of an MNE’s residual (non-routine) profits to the market jurisdiction. The profit allocation mechanism of Amount A involves three steps: first, the

135. OECD, supra note 94, at 59; note that this estimation does not indicate whether and to what extent all of these MNEs will indeed be subject to the new tax, because such determination depends on activity in the market jurisdiction (the market threshold). This simply means that the maximum number of MNEs that can possibly be subject to the new right is approximately 2,300.

136. The Pillar One Blueprint justifies the distinction between automated digital services and consumer-facing businesses in the difference of market presence, profitability, and compliance burdens between the two. Consumer-facing businesses are not as profoundly able to participate remotely in market jurisdictions. Moreover, profit margins for consumer-facing businesses are typically lower than for automated digital services, and with higher complexity and compliance costs, which points to the higher threshold and “plus factors.” See id. at 65.

137. Id. at 65-66.

138. Id. at 66.

139. Id. at 66.

140. Id. at 66-68. The Inclusive Framework also recommends a “plus-factor” presence test for determining significant market activity for consumer-facing businesses.

141. Id. at 71-72. Sourcing principles are identified for each in-scope revenue and are coupled with indicators to determine the source jurisdiction. See id. at 73-99 for list and description of relevant sourcing rules.

142. Id. at 8. The new norm goes beyond existing norms, such as the arm’s-length principle and Authorized OECD Approach. Under current international tax rules, profit attribution is generally governed by Articles 7 (Business Profits) and 9 (Associate Enterprises) of the OECD Model Tax Convention. Article 7 provides that profits of an enterprise that are attributable to the PE may be taxable in that State. Article 9 provides that States have taxing rights over enterprises transacting with associate enterprises. See OECD Model Tax Convention, supra note 26, at arts. 7, 9.
MNE group’s routine profits would need to be identified, and a profitability threshold would separate the allocable residual (non-routine) profits from routine activities. Routine functions are excluded from the pool of profits that would be allocated to the market jurisdiction. Pillar One recognizes that some companies may need to calculate their Amount A tax base on a segmented basis, which would be derived from the consolidated financial statements under the accounting standards of the MNE’s headquarter jurisdiction. Second, Pillar One would determine a fixed reallocation percentage from the share of residual (non-routine) profits that would be allocated to market jurisdictions under Amount A. This step excludes factors such as trade intangibles, capital, and risk from allocation to the market jurisdiction. The allocable tax base would therefore be determined through a fixed percentage of the residual profits. The final step would be to allocate the relevant portion of the deemed residual (non-routine) profits among the eligible market jurisdictions (where nexus has been created). Note that the Amount A calculation would be subject to a marketing and distribution safe harbor. This would cap Amount A allocations with respect to market jurisdictions that already enjoy taxing rights over an MNE’s residual profits. Consequently, an MNE would not incur Amount A tax liability if existing marketing and distribution profits exceed its safe harbor return. The Amount A allocation would be performed by filing a standardized self-assessment return and documentation package with the parent jurisdiction, which would then be exchanged between tax administrations relevant to the MNE’s operations. To better provide early tax certainty, Amount A would include a binding dispute prevention and resolution mechanism.

Consider the following simplified example for applying the new taxing right under Amount A, where an MNE does not maintain physical presence in the market jurisdiction. Assume that MNE XGroup provides online streaming services. YCorp (resident of Country 1) is the parent company of XGroup. It owns XGroup’s intangible assets and is entitled to all its non-routine profits. ZCorp (resident of Country 2), a subsidiary of YCorp, is responsible for marketing and distributing XGroup’s streaming services. Assume also that in Country 3, XGroup does not maintain a taxable presence under existing rules. ZCorp, however, makes remote sales in Country 3. XGroup has €800 million of global gross revenues and makes sufficient sales to satisfy the market threshold of Country 3. It is necessary to determine whether Country 3 has a right to tax the profits of XGroup under the new taxing right. Because both the global gross

143. OECD, supra note 94, at 123.
144. These statements are typically prepared in accordance with the Generally Accepted Accounting Principles (GAAP) or the International Financial Reporting Standards (IFRS). Note that Amount A includes loss carry-forward rules. Unlike profits, losses accrued in a tax period would not be allocated to a market jurisdiction. Id. at 98-102.
145. Id. at 123.
146. Id.
147. Id. at 123-24.
148. Id. at 170.
149. Id. at 190.
150. Example provided originally by OECD. See OECD, supra note 110, at 12.
revenue and market revenue thresholds are satisfied, XGroup has tax nexus in Country 3. Assuming all other necessary criteria are met, Country 3 would have the right to tax a portion of the deemed residual (non-routine) profits of XGroup (Amount A), in an amount not exceeding the marketing and distribution cap. Country 3 may tax that income directly from YCorp, since YCorp is considered to have a taxable presence in Country 3 under the new Pillar One nexus rules.\footnote{151} Amount A would be allocated after a return is filed with the parent jurisdiction, which would be subject to a panel review of interested tax administrations if necessary.\footnote{152} The new rule thus redistributes international taxing rights to market jurisdictions. It also limits profit shifting by creating tax liability in the source country and allocating profits to the market jurisdiction even when an MNE does not have physical presence in a market. The implementation of Pillar One will then require translation and adoption into the domestic laws of jurisdictions.\footnote{153} A new multilateral convention may be necessary to implement Amount A on an international scale and to remove existing barriers within bilateral tax treaties.\footnote{154}

4. Amount B

Amount B applies only by way of traditional physical nexus in the market jurisdiction. It is not applicable by way of the new taxing right (Amount A), which is administered irrespective of physical nexus. Amount B establishes a fixed return for certain “baseline” or routine marketing and distribution functions that occur in the market jurisdiction.\footnote{155} The fixed return under Amount B aims to reduce disputes, particularly with respect to applying transfer pricing rules. Amount B would benefit tax administrations and taxpayers by increasing tax certainty and reducing the risk of double taxation.\footnote{156}

5. Initial U.S. Response

In response to the progress on Pillar One, U.S. Secretary of the Treasury under the Trump administration, Steven Mnuchin, expressed that the U.S. has “serious concerns regarding potential mandatory departures from arm’s-length transfer pricing and taxable nexus standards — longstanding pillars of the international tax system upon which U.S. taxpayers rely.”\footnote{157} According to Mnuchin, the goals of Pillar One could be accomplished by making Pillar One an optional “safe harbor” regime.\footnote{158} A safe harbor regime suggests that companies would be able to opt into Pillar One and elect whether the new rules would apply. The U.S. Treasury wishes to protect U.S.-based MNEs from paying
tax in other countries, thereby also protecting the interests of taxing rights of the U.S. as the residence country. Consider that any tax policy that redistributes taxing rights to source countries hurts U.S. interests as a predominantly residence country (of MNEs). By the OECD’s own assessment, digital tech hubs exporting research and development (R&D) would lose the most from Pillar One’s redistribution of taxing rights among jurisdictions. Implementing Pillar One as a safe harbor would undermine the OECD’s efforts because it would encourage tax planning on the part of MNEs, who would be enabled to make business decisions based on tax considerations. Profit shifting would then be stimulated, rather than eliminated. The prospect of implementing Pillar One entirely as a safe harbor has largely been rejected by the OECD.

The OECD’s tax reform plans hit a roadblock when Mnuchin, in a June 2020 letter addressed to four European finance ministers, expressed that global discussions had reached an impasse. According to Mnuchin, the U.S. is unable to agree on changes to international tax law affecting U.S. digital companies. Mnuchin added that “this is a time when governments around the world should focus their attention on dealing with the economic issues resulting from COVID-19.” Despite the discouraging statements, Pascal Saint-Amans, director of the OECD Centre for Tax Policy and Administration, has ensured that discussions on international tax reform remain ongoing and that the U.S. is still present and engaged in the negotiations.


162. Id.

163. Id.

164. Saint-Amans spoke at a Bloomberg Tax and Accounting event on June 24, 2020. Saint-Amans expressed that the U.S. has not “walked away” from negotiations, unlike what has been reported. Saint-Amans stated that the U.S. remains engaged in negotiations to achieve a multilateral solution but believes that an agreement should be pushed to 2021 or at least after the U.S. presidential election in November 2020. The timeline for achieving a consensus-based solution has indeed been pushed to mid-2021. See David Schultz, Talking Tax: Pascal Saint-Amans on Progress With Global Tax Talks, BLOOMBERG TAX, https://news.bloombergtax.com/daily-tax-report/pascal-saint-amans-on-progress-
On January 25, 2021, Dr. Janet Yellen was confirmed as U.S. Secretary of the Treasury under the Joe Biden administration. In her nomination hearing before the U.S. Senate Committee on Finance, Yellen expressed that the Biden administration is “committed to the cooperative multilateral effort to address base erosion and profit sharing through the OECD/G20 process, and to resolving the digital taxation disputes in that context.”165

6. Notes on Pillar Two

On November 8, 2019, the Secretariat of the OECD published a proposal for Pillar Two of its two-pillar approach titled “Global Anti-Base Erosion Proposal (“GloBE”): Pillar Two.”166 On October 14, 2020, the OECD released its Report on the Pillar Two Blueprint, together with the Pillar One Blueprint.167 Pillar Two complements Pillar One by addressing remaining BEPS challenges.168 It is designed to ensure that the profits of MNEs are subject to a minimum rate of tax irrespective of where they are headquartered or the jurisdictions in which they operate.168 A minimum rate of corporate income tax would reduce taxpayers’ incentive to engage in profit shifting and would establish a floor for tax competition among jurisdictions.169 According to several models, a global minimum tax rate is anticipated to generate tax revenues worldwide,170 and Pillar Two has generally encountered broader support among developed countries.171 The global minimum corporate tax is viewed as an important measure to reduce tax planning and profit shifting by MNEs. Secretary Mnuchin, for example, has expressed the U.S.’s full support of Pillar Two, unlike the concerns presented over Pillar One.172 Mnuchin also insisted that Pillar Two discussions remain on track, despite the disagreements on Pillar One.173 Pillar Two is an anti-tax haven measure that will benefit the U.S. and other large economies and will require broad coordination and cooperation among jurisdictions in order to be administered.174

with-global-tax-talks-podcast at 05:30 (June 25, 2020).

165. Yellen responded to a question posed by Senator Chuck Grassley. See U.S. Senate, Committee on Finance, Finance Committee Questions for the Record, Hearing on the Nomination of Dr. Janet Yellen: Responses by Dr. Yellen, at 8 (Jan. 21, 2021).


168. Id. at 14.

169. OECD, supra note 166, at 6.


173. Steven Mnuchin Letter to Finance Ministers, supra note 161.

174. Pillar Two includes an “income inclusion rule” that would tax the income of a foreign branch or a controlled entity if that income was subject to tax at a rate below the minimum rate. OECD, supra
A public consultation on the Pillar Two Proposal was held on December 9, 2019, where companies such as Amazon and Unilever expressed support for Pillar Two, endorsing it as an important step towards a coherent international tax system. Public consultations on the Pillar One and Two Blueprints were opened for stakeholder input and held in January 2021. Following the release of the Pillar Two Proposal, Minister Le Maire expressed support for both pillars and suggested a 12.5% rate for global minimum taxation. Some have conveyed criticism that a global minimum tax impedes on the sovereign right of countries to elect their own corporate tax rate. Irish Finance Minister Paschal Donohoe, for example, has conveyed Ireland’s opposition to any kind of global minimum tax proposal. Ireland, among other low-tax jurisdictions and tax havens, would lose its competitive advantage as well as some jurisdictional sovereignty in a global minimum tax regime.

7. Impact Assessments

Several estimates of revenue effects of the OECD reforms have emerged. Copenhagen Economics estimates that in 2017, 18% to 21% of the corporate tax base in Sweden, Denmark, and Finland was derived from foreign residual profits. In Germany, that share was approximately 17%. Copenhagen Economics found that under the OECD proposal, the bulk of this corporate tax revenue would be allocated to different countries. The losses these countries will suffer can be attributed to their intensive R&D exporting sectors, which have substantial residual returns. The R&D industry exporters are targets of the new taxing right due to their reliance on intangibles and digital business models that do not depend on physical presence.

According to a November 2019 report by the French Council of Economic Analysis, Pillar One would negligibly affect tax revenues in most non-tax

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note 167, at 112-14.


182. The February 2019 report analyzes the OECD’s original marketing intangibles approach, which has since developed into the Pillar One Proposal. Id.

183. The French Conseil d’analyse économique (Council of Economic Analysis) is an
haven countries.\textsuperscript{184} Pillar Two, however, would reduce profit shifting and generate substantial tax revenues, without significantly impacting the attractiveness of countries as a location to conduct business.\textsuperscript{185} According to the French Council of Economic Analysis, the Pillar One Proposal generates an equal number of winners and losers in terms of redistributing tax revenues, and more winners than losers in terms of attractiveness for business.\textsuperscript{186} The Pillar Two Proposal would generate tax revenue gains across countries without significantly affecting their attractiveness.\textsuperscript{187}

Former President of the Swiss Confederation Ueli Maurer has stated that Switzerland’s tax revenues could drop by over CHF 5 billion (around $5.6 billion) as a result of Pillar One.\textsuperscript{188} According to Erik de Vrijer, assistant director at the European department at the IMF, between €1.5 to €3 billion of Ireland’s corporate tax revenue could be at risk from the international tax reforms.\textsuperscript{189} Reallocating corporate tax revenue based on the location of sales would narrow Ireland’s tax base as a small export-centric economy. Low tax jurisdictions such as Switzerland, Ireland, and Luxembourg would be drastically affected by the global tax overhaul because their R&D exports would be targeted (by Pillar One), and their favorable tax treatment would be devalued (by Pillar Two).\textsuperscript{190}

According to OECD economic impact assessments, the combined effect of Pillars One and Two would lead to significant increases in global tax revenues and a redistribution of taxing rights to market jurisdictions.\textsuperscript{191} The OECD estimates that Pillar One would reallocate approximately $100 billion of taxing rights to market jurisdictions.\textsuperscript{192} On average, low- and middle-income economies would gain from Pillar One, experiencing a higher rate of increase in revenues than high-income economies, even though larger market jurisdictions will benefit more in absolute terms. Investment hubs, where levels of residual profits are high, would experience significant losses in tax base.\textsuperscript{193} These investment

\textsuperscript{184} Fuest et al., supra note 170, at 1.  
\textsuperscript{185} Id.  
\textsuperscript{186} The French Council model examined 40 countries. Id. at 10.  
\textsuperscript{187} Id.  
\textsuperscript{191} OECD, supra note 159, at 12.  
\textsuperscript{192} OECD, Tax Challenges Arising from Digitalisation: Economic Impact Assessment, at 10 (2020), https://read.oecd.org/10.1787/0e3cc2d4-en?format=pdf. Combining these effects with the U.S. Global Intangible Low-Tax Income regime, total gains could be $60-100 billion per year.  
\textsuperscript{193} Id.; OECD, supra note 159, at 12.
hubs include traditional tax havens where corporate tax rates are 0%,\textsuperscript{194} but also countries such as Ireland and Switzerland that have low corporate income tax rates and high levels of residual profits.\textsuperscript{195} Countries that rely on residual profits and that have low corporate income tax rates would lose the most by every assessment. Overall, the OECD projects that Pillars One and Two would increase global corporate income tax revenues by a combined $50-80 billion dollars per year.\textsuperscript{196}

V. DIGITAL SERVICES TAXES

A. Unilateral Measures

The OECD’s efforts to address BEPS began in 2012 and remain ongoing. While the OECD continues to labor on a multilateral solution, several countries have responded to the tax challenges of digitalization by enacting unilateral measures. Administrations are eager to tax revenues of highly digitalized MNEs that commercially engage in their jurisdictions, often without a physical presence. This desire is particularly notable during the COVID-19 pandemic in which governments are struggling to finance the momentous costs of a global health crisis.

Recall that according to the EC, digital and traditional domestic businesses within the EU are subject to effective tax rates of 8.5% versus 20.9% respectively.\textsuperscript{197} Similarly, digital and traditional international businesses are subject to effective tax rates of 10.1% versus 23.2%, respectively.\textsuperscript{198} In November 2019, the French Council of Economic Analysis estimated that MNEs have significantly reduced their corporate tax burdens in France by shifting profits to low tax jurisdictions. Revenue losses to the French government as a result of profit shifting amount to €4.6 to €10 billion of annual tax revenues.\textsuperscript{199} Remarkably, the U.K. and Germany each lose over a whopping €12 billion a year to tax havens,\textsuperscript{200} and Austria, Sweden, Spain, and Italy lose several billions annually as well. Estimates show that in 2015, more than $600 billion in global profits were shifted to tax havens.\textsuperscript{201} A European Parliament study has estimated that corporate tax revenue losses for the EU due to profit shifting amount to

\textsuperscript{194} Such as the Cayman Islands, Bermuda, and Bahamas.
\textsuperscript{195} OECD, supra note 159, at 12.
\textsuperscript{196} OECD, supra note 192.
\textsuperscript{197} See 2017 EC Communication, supra note 58, at 6; According to the IFO Institute for Economic Research, digital businesses were subject to tax rate of 20.9%, whereas traditional businesses were subject to a tax rate of 26.7%. See Fuest et al., supra note 170, at 6.
\textsuperscript{198} 2017 EC Communication, supra note 58, at 6.
\textsuperscript{199} Fuest et al., supra note 170, at 4-5; Thomas R. Torsløv et al., The Missing Profits of Nations, at 55, at Table 2 (NBER, Working Paper No. 24701, June 2018).
\textsuperscript{201} Torsløv et al., supra note 199, at 21.
approximately €50-70 billion per year.\textsuperscript{202} Within the EU, it is widely agreed that highly digitalized MNEs do not pay their fair share of taxes, and that MNEs use aggressive tax planning strategies to reduce their effective tax burdens.\textsuperscript{203} The EC has claimed that this unlevel playing field is economically inefficient and hurts innovation, growth, and welfare, while burdening taxpayers and eroding tax bases.\textsuperscript{204} In order to collect more tax revenue from highly digitalized MNEs, several countries have begun imposing unilateral digital services taxes (DSTs) on foreign companies.

DSTs generally apply to revenues derived from activities where users play a major role in value creation. These include revenues created from the placement of online advertising, sale of user collected data, and by digital platforms that facilitate interactions between users.\textsuperscript{205} DSTs usually take the form of 2% to 7% flat taxes on gross revenues from taxable digital services earned by large MNEs in a given jurisdiction. Under a DST, taxable entities are businesses that typically meet both an MNE group (global revenue) threshold and a market revenue threshold. Only an entity meeting both thresholds will be subject to a country’s DST. The market threshold refers to sales from taxable digital services reported in the relevant jurisdiction. Global revenue thresholds, referring to the revenues of the MNE, are €750 million in Italy, Spain, Austria, France, and the Czech Republic, and £500 million in the U.K.\textsuperscript{206} Market revenue thresholds are €25 million in France and Austria,\textsuperscript{207} £25 million in the U.K.,\textsuperscript{208} CZK100 million in the Czech Republic,\textsuperscript{209} €5.5 million in Italy,\textsuperscript{210} and €3

\textsuperscript{202} This reflects the European Parliament’s lower end estimate of the sum lost to profit shifting in the EU. If, however, other issues such as special tax arrangements, inefficiencies in collection and other practices are included, the revenue loss estimate rises to approximately €160-190 billion per year. See Robert Dover et al., \textit{Bringing transparency, coordination and convergence to corporate tax policies in the European Union: Part I: Assessment of the magnitude of aggressive corporate tax planning}, at 6 (European Parliament, Research Paper, 2015).

\textsuperscript{203} 2018 EC Impact Assessment, \textit{supra} note 200, at 136-38.

\textsuperscript{204} \textit{Id.} at 135-37.


\textsuperscript{207} Austria Digital Tax Act, \textit{supra} note 2016.; France Digital Tax Bill, \textit{supra} note 205.

\textsuperscript{208} See HMRC Digital Services Tax, \textit{supra} note 206.

\textsuperscript{209} See Czech DST Proposal, \textit{supra} note 206.

\textsuperscript{210} See Italian DST, \textit{supra} note 206.
million in Spain.\footnote{211}

While the EU has supported the discussions led by the OECD, it remains committed to acting on its own if a global solution is not reached on digital taxation.\footnote{212} The EU’s 2021-2027 long-term budget estimated that an EU-wide digital tax would raise approximately €1.3 billion of annual revenues.\footnote{213} Levying an EU-wide tax on companies with a turnover above €750 million is incorporated as part of a recovery plan intended to “give the Union the best possible chance of success” in the wake of the COVID-19 crisis.\footnote{214} In a June 2020 interview, EU Executive Vice President of the EC Margrethe Vestager expressed that a global consensus on digital taxation is the “absolutely preferable situation,” but that the EU will push ahead on its own if necessary.\footnote{215}

Many non-EU States have also adopted or announced direct taxes on digitalized businesses, through DSTs or by modifying the PE concept.\footnote{216} The Liberal Party of Canada announced a 3% tax on companies with global revenues of at least C$1 billion and revenues in Canada of more than C$40 million.\footnote{217} In 2016, India introduced a 6% equalization levy on online advertising payments exceeding INR100,000, applying to non-residents without a PE in India.\footnote{218} India’s Finance Act 2020 expanded the equalization levy, providing that effective April 2020, a 2% equalization levy will be applied to the revenues of e-commerce operators and suppliers.\footnote{219}

In 2016, the Israel Tax Authority introduced an interpretive regulation setting forth a “digital PE” concept if substantial digital services are supplied to Israeli consumers.\footnote{220} In May 2020, the Government of Kenya passed the Kenya

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211. See Spanish Digital Services Tax, supra note 206.
213. Id.
214. Id. at 16.
216. Particularly the French DST.
219. The new rule expands the equalization levy from advertising to online commerce, a lot more broadly. The Indian Finance Act of 2020, No. 12 of 2020, 63 (Mar. 27, 2020).
220. See Israel Tax Authority, Circular No. 4/2016 Activities of foreign corporations in Israel
Finance Bill 2020 which establishes a DST under Section 12E of the Kenyan Income Tax Act.\textsuperscript{221} The Kenyan DST is a 1.5% gross revenue tax on income from services derived or accrued through digital marketplaces in Kenya.\textsuperscript{222} In December 2019, the Government of Turkey passed a DST effective in March 2020.\textsuperscript{223} The legislation is a 7.5% gross income tax on digital services including advertising, audio, visual and digital content, and online platforms.\textsuperscript{224} In 2018, the Government of Pakistan enacted a 5% withholding tax on payments for offshore digital services by non-resident persons. Such services include online advertising and distribution of digital content.\textsuperscript{225} According to a January 2021 KPMG summary, 38 countries have either announced, drafted or legislated direct taxes targeting the digital economy.\textsuperscript{226} These include DSTs and withholding taxes, as well as amendments to PE definitions to include digital PE.\textsuperscript{227} Note that as of January 2021, 36 of the 38 countries working to directly tax the digital economy were members of the OECD’s Inclusive Framework.\textsuperscript{228}

\textbf{B. Digital Services}

DSTs target revenues derived from covered digital services. Just as it is difficult to define the “digital economy,” it is hard to categorize “digital services,” and definitions may differ among tax administrations. Digital services may be comprised of a variety of online functions, including streaming content (e.g. Netflix, Spotify), e-commerce platforms (e.g. Amazon, eBay, Alibaba), platform connectors (e.g. Uber, Lyft, Airbnb), social networks (e.g. Facebook, Twitter, LinkedIn), messaging services (e.g. WhatsApp, Telegram, WeChat), search engines (e.g. Google, Bing, Yahoo!), electronic payment services (e.g. PayPal, Venmo) and gaming (e.g. Rockstar Games, Electronic Arts, Ubisoft). The French Digital Tax Bill, for example, covers targeted online advertising, sales of user data for advertising purposes, and online intermediation platforms.\textsuperscript{229} Sales through digital marketplaces Amazon and eBay, targeted advertising through Facebook, and transactions through digital intermediary

\footnotesize{through the internet (Apr. 11, 2016), translated at https://taxes.gov.il/English/About/SpeakersAnnouncements/Pages/Ann_11042016.aspx.
\textsuperscript{222} Id.
\textsuperscript{224} Id.
\textsuperscript{226} As of January 15, 2021, three additional countries (Australia, Chile and Germany) have abandoned their proposals, seven are “waiting for global solution,” whereas several others have implemented indirect taxes on the digital economy such as VAT. See KPMG Summary, supra note 2, at 4.
\textsuperscript{227} Id.
\textsuperscript{228} Taiwan and Zimbabwe are the two exceptions. See OECD, supra note 1.
\textsuperscript{229} France Digital Tax Bill, supra note 205, at 6.}
platforms Airbnb and Uber, would therefore be within the scope of the French DST. Transactions where a digital interface sells goods or services that it owns are usually excluded from DSTs. For example, if Amazon sells goods from its own inventory, or if a consumer books a room directly through a hotel website, those activities would be excluded from the DST. In general, DSTs cover digital intermediary services that connect users to each other. DSTs do not target the pure purchase of goods online, which is typically entrusted to consumption taxes such as VAT.

C. Tax Burden and Credibility

Although DSTs target large digital companies, their tax burden is rolled over and ultimately borne by consumers. In response to the French Digital Tax Bill, Amazon announced that it will increase seller fees on its Amazon.fr site by 3%. A similar announcement has been posted on Amazon’s U.K. seller website, increasing fees for sellers by 2% due to the U.K. DST. Representatives from Facebook and Google have condemned the levying of DSTs, while expressing support for the OECD’s multilateral efforts.

In May 2020, French Minister of Economy and Finance Bruno Le Maire announced that the French DST has already generated €350 million during its first year. Notably, however, a previous Deloitte impact assessment estimated that the total additional tax burden of the French DST is approximately

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231. Id. Giving access (for remuneration) to a digital marketplace for buying and selling cars is considered a digital service, but the sale of a car itself through such a website is not.


237. Deloitte is a multinational professional services network that provides audit and assurance, tax, consulting, and risk and financial advisory services to corporations and governmental agencies worldwide. For more on Deloitte, see Deloitte, About Us, https://www2.deloitte.com/us/en/footnotelinks/about-us-deloitte.html?cid=bottom_about-us-deloitte.
€570 million—significantly more than the tax revenue it ultimately raised.238 The tax burden mostly reflects a rise in price levels and reduced corporate profits. Increased tax liability is borne by consumers and businesses using digital marketplaces, not by large digital-tech companies. The latter pass on their increased tax burden, resulting in higher prices for consumer goods and reduced profits for businesses using digital platforms.239 Approximately 55% of the total tax burden is borne by consumers, 40% by businesses that use digital platforms, and only 5% by the large digital companies originally targeted by the DST.240 DSTs also increase the risk of unrelieved double taxation,241 because the same tax base may be taxed several times.242 Under a DST, companies are subject to tax liability in foreign jurisdictions and could claim a foreign tax credit (FTC), exemption, or deduction in their country of residence. For example, U.S.-based companies could be subject to corporate tax liability in the U.S. as well as a DST in a country such as France. Under U.S. law, corporations can claim FTC against U.S. corporate income tax liability for income taxes paid to foreign jurisdictions.243 To minimize tax liability, companies such as Google and Facebook that pay the French DST could claim a U.S. FTC dollar-for-dollar against the DST paid in France. Such claims, if accepted, will greatly reduce U.S. corporate income tax liability, together with the taxable revenue of the U.S. Treasury. Note however that DSTs will not necessarily be eligible for U.S. FTCs, and would possibly fail the “income test” of Reg. § 1.901-2(b)(4).244 DSTs are taxes levied on revenues earned from specific business activities and may not be considered corporate income taxes, at least by U.S. standards.245 DST payments are thus not necessarily creditable against corporate taxes paid in the residence country.246 This may result in taxation levied in the source country (e.g. France), as well as taxation levied on the same tax base in the residence country (e.g. U.S.); in other words, double taxation.

Allowing DST revenues to be creditable would force the U.S. Treasury to effectively subsidize unilateral DST regimes,247 thereby forfeiting large amounts of tax revenue. In the event a DST is creditable, an MNE would indeed pay the tax, but the tax burden would be shifted to the U.S. Treasury and to U.S.

239. Id. at Executive Summary.
240. The Deloitte Assessment predicted that lack of available data, differences in interpretation of French law and lack of guidance to calculate the tax liability could lead to high administrative costs for the French DST. See id. at 27-36.
244. 26 C.F.R. § 1.901-2(b)(4) (2019).
245. Lowry, supra note 243, at 21; U.S. Trade Representative, supra note 230, at 48.
246. Note that businesses that pay the France DST and are also subject to the corporate income tax in France will be able to deduct the DST payment from their taxable income.
taxpayers due to the issuance of the credit. Consider in addition that the tax burden of DSTs is shifted directly to consumers (e.g. the Amazon FR and UK seller announcements), which still does not alleviate the tax gap between digital and non-digital businesses. A multilateral agreement is therefore important to increase tax certainty and alleviate double taxation or double non-taxation.\textsuperscript{248} Also note that Pillar One is drafted as a standalone rule applying on top of the existing PE norm. If a jurisdiction does not withdraw a unilateral DST measure, the risk of multiple taxation is intensified when Pillar One is implemented.

\textbf{D. Reaction to DSTs}

Unilateral DSTs have become popular yet controversial. The OECD considers DSTs as uncoordinated unilateral tax measures that “undermine the relevance and sustainability of the international tax framework.”\textsuperscript{249} The OECD has expressed the need to deliver a solution that would prevent “aggressive unilateral measures” given the intense political pressure to tax highly digitalized MNEs.\textsuperscript{250} DSTs have been emphatically opposed by U.S. officials, who view them as discriminatory measures against U.S.-based companies and a deviation from traditional tax principles.\textsuperscript{251} The predominance of unilateral DSTs is one of the most significant challenges facing the OECD in achieving an agreement on multilateral tax reform.

As noted, DSTs have been critiqued as discriminatory taxes that almost exclusively target U.S.-based companies\textsuperscript{252} while undermining international tax principles and coordinated multilateral efforts.\textsuperscript{253} DSTs apply only to large digital companies, due to their high global revenue thresholds. Under most DST regimes, only companies exceeding annual global revenue of €750 million are subject to the tax. As a result, DSTs apply primarily to U.S.-based digital companies.\textsuperscript{254}

According to a 2017 UN report, two-thirds of digital MNEs were headquartered in the U.S.\textsuperscript{255} In 2019, Forbes estimated that eight of the ten world’s largest internet companies were U.S.-based.\textsuperscript{256} Of Forbes’ Top 100 list,

\begin{itemize}
\item\textsuperscript{249} The OECD also provides that DSTs will harm global investment and growth. See OECD, supra note 110, at 4.
\item\textsuperscript{250} \textit{Id.}
\item\textsuperscript{252} Mason & Parada, supra note 241, at 1185-93.
\item\textsuperscript{253} OECD, supra note 110, at 4.
\item\textsuperscript{254} The EC Commission Impact Assessment expressed that “large digital multinationals are particularly concentrated in the United States.” See 2018 EC Impact Assessment, supra note 200, at 113.
\item\textsuperscript{256} The Forbes Top 100 list, current as of September 29, 2019, examined the most recent sales,
nine companies were headquartered in China,²⁵⁷ reflecting the dominance of the U.S. and China in the digital economy.²⁵⁸ Recall that as of December 2019, the world’s five largest companies by market capitalization were Apple, Microsoft, Amazon, Alphabet (Google), and Facebook, in relevant order.²⁵⁹ All are U.S.-based digital companies that have significant commercial activity in markets outside the U.S. These companies collect and market user data, and offer digital intermediary platforms and online advertising. DSTs are tailored to capture companies of this scale (over €750 million in revenues) that engage in digital services activities in market jurisdictions. Mainstream media has often referred to unilateral DSTs as “Facebook taxes” or “Google taxes,”²⁶⁰ because DSTs apply only to this subset of companies. French Minister of Economy and Finance Bruno Le Maire has referred to the French DST as the “GAFA tax,” meaning the “Google, Apple, Facebook, Amazon tax.”²⁶¹ The Government of France website page announcing the outlines of the “GAFA” tax even features the logos of Google, Apple, Facebook and Amazon, as if indicating the companies subject to the tax.²⁶² Note that targeting U.S.-based companies conflicts with the fundamental international tax principle of nondiscrimination, which provides that the source country must not tax income in a manner that discriminates against foreigners.²⁶³

The U.S. Trade Representative estimated that the French DST applies to 27 company groups, 17 of which are U.S.-based, including Google (Alphabet), Apple, Facebook and Amazon. Only one French company, Criteo, would likely be subject to the French DST.²⁶⁴ According to a 2017 study by Gary Clyde Hufbauer and Zhiyao (Lucy) Lu, an EU-wide DST would apply only to U.S.-based digital firms, except for Spotify.²⁶⁵ The policy of targeting large U.S.-
based companies recalls one of the most famous tax aphorisms, articulated by the late U.S. Senator Russell Long: “Tax reform means don’t tax you, don’t tax me, tax that fellow behind the tree!”266 In the case of DSTs, Google, Amazon, Facebook and Apple are that fellow behind the tree.

Scholars have critiqued the U.S.-targeted application of DSTs as a harmful and intellectually indefensible267 move that at most amounts to a mercantilist ring-fencing of the digital economy.268 The OECD has also stated that because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy for tax purposes.”269 The OECD explains that attempting to isolate the digital economy as a separate sector inevitably requires drawing arbitrary lines between what is digital and what is not.270 While the OECD’s Pillar One scope purports to go beyond highly digitalized business models, DSTs narrowly apply to a subset of digital services activities.

Unilateral DSTs have encountered political scrutiny from R&D exporting countries and digital technology hubs. In June 2019, the Ministers of Finance of Sweden, Denmark and Finland presented a joint statement endorsing global cooperation on digital taxation within the OECD while opposing unilateral DSTs.271 The Finance Ministers stated that DSTs deviate from internationally established tax principles by taxing gross income regardless of whether an enterprise is profitable.272 The Finance Ministers conveyed that such substantial changes to current tax principles need to be discussed and agreed upon at an international level.273 The Irish Parliament has also opposed DSTs, stating that there is no single definition of what constitutes the digital economy and that a DST is a narrow solution to reforming the PE concept.274 The People’s Republic of China, home to many large MNEs including two of the world’s largest digital companies—Alibaba and Tencent—is a main target of DSTs, along with the

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267. Grinberg, supra note 28, at 87 (calling DSTs intellectually indefensible); Mason & Parada, supra note 241, at 1185-86 (expressing that DSTs are discriminatory). Some scholars have defended DSTs, with the notion that DSTs need to be understood as allowing the country where a “rent” is located to tax the rent. See, e.g., Wei Cui, The Digital Services Tax: A Conceptual Defense, Tax L. Rev. (forthcoming).
268. Grinberg, supra note 28, at 87.
269. OECD, supra note 5, at 11.
270. Id. at 54.
271. Global cooperation is key to address tax challenges from digitalization, MINISTRY OF FINANCE, GOVERNMENT OFFICES OF SWEDEN (June 1, 2018), https://www.government.se/statements/201806/global-cooperation-is-key-to-address-tax-challenges-from-digitalization/.
272. DSTs do not consider the losses of an MNE group.
273. Despite issuing the joint statement, Danish Prime Minister Mette Frederiksen stated that Denmark would support an EU-wide agreement on taxing digital services if a global agreement will fail on an OECD level. According to Frederiksen, Denmark did not support an EU-wide digital tax in the past but does now. See Morten Buttler, Denmark Supports EU-Wide Deal on Digital Tax, Premier Says, Bloomberg, Jan. 8, 2020, https://www.bloomberg.com/news/articles/2020-01-28/frederiksen-says-denmark-supports-eu-wide-deal-on-digital-tax.
U.S.\textsuperscript{275} Whereas China will be harshly affected by the DSTs, it has been mostly silent in the digital tax debate and has not voiced a notable public position on the matter.\textsuperscript{276} Nevertheless, in December 2020, China reportedly considered imposing a digital tax on technology companies that hold user data.\textsuperscript{277}

The U.S., home to most of the world’s largest digital technology companies, is the most dominant opponent of DSTs and has led the battle against their implementation. The U.S. wishes to protect U.S.-based companies from foreign tax liability, and most importantly, protect its own taxable revenue from foreign hands.\textsuperscript{278} Former House Ways and Means Committee Chairman Kevin Brady has stated that DSTs are a blatant revenue grab inconsistent with international norms.\textsuperscript{279} U.S. Treasury Deputy Assistant Secretary for International Tax Affairs under the Trump administration, Chip Harter, expressed that DSTs are “ill conceived” and that the U.S. opposes any DST proposal.\textsuperscript{280} This position has been echoed by Secretary Mnuchin, who has stated that the U.S. “firmly opposes digital services taxes because they have a discriminatory impact on U.S.-based businesses and are inconsistent with the architecture of current international tax rules.”\textsuperscript{281} Mnuchin also asserted that DSTs threaten the longstanding multilateral consensus on international taxation.\textsuperscript{282} U.S. Senate Finance Committee Chair Charles E. Grassley and ranking member Ron Wyden have also condemned unilateral actions,\textsuperscript{283} with Wyden stating that a post-Brexit trade agreement with the U.S. will not happen if a U.K. DST is in place.\textsuperscript{284} In September 2020, Rep. Ronald Estes (R-KS) introduced a House resolution strongly opposing the imposition of DSTs that “discriminate against United States companies.”\textsuperscript{285} The resolution calls on

\begin{itemize}
\item \textsuperscript{275} Peter A. Barnes & H. David Rosenbloom, \textit{Digital Services Taxes: How Did We Get Into This Mess?}, 97 Tax Notes Int’l 1255, 1256 (2020).
\item \textsuperscript{276} China’s silence on the subject as well as its interest in protecting the revenue of its MNEs could suggest that it does not endorse unilateral DSTs. Yue “Daisy” Dai, \textit{China’s Surprising Silence on Digital Taxation}, 13 Tax Notes Int’l 1301, 1301 (2019).
\item \textsuperscript{278} See CNBC Television, \textit{Breaking: President Trump responds to France’s tax on American companies, might impose wine tax}, (Jul. 26, 2019), https://www.youtube.com/watch?v=3KItW1vPv4Q. President Trump commented that France’s DST on U.S. companies was the “wrong thing to do,” and that “we [the U.S.] tax our companies, they [France] don’t tax our companies.” Trump threatened to impose a punitive tax on French wine because of the DST.
\item \textsuperscript{279} Press Release, Brady Statement on U.K. Tax on Digital Services, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES (Oct. 31, 2018).
\item \textsuperscript{281} Steven Mnuchin Letter to Gurria, \textit{supra} note 157.
\item \textsuperscript{282} \textit{Id.}
\item \textsuperscript{285} H.R. Res.1097, \textit{supra} note 251.
\end{itemize}
countries to withdraw and refrain from DSTs, and on U.S. Government agencies to protect U.S. companies “from the discriminatory effects of DSTs.”

E. U.S. Retaliation and Section 301 Investigations

Among the most widely publicized controversies in the international tax realm has been the U.S.-France dispute over the French DST. As a response to the French legislation, U.S President Donald Trump ordered Trade Representative Robert Lighthizer (USTR) to initiate a Section 301 Investigation into France’s DST. Section 301 of the Trade Act of 1974 authorizes the President of the U.S. to take all appropriate action, including tariff-based retaliation, to remove any act, policy, or practice of a foreign government that violates an international trade agreement or is unjustified, unreasonable, or discriminatory, and that burdens or restricts U.S. commerce. Section 301 is a unilateral action by the U.S. government that does not rely on the dispute settlement system of the World Trade Organization (WTO) or its stipulated timeline. Since the WTO’s establishment in 1995, the U.S. has primarily used Section 301 to pursue dispute settlement through the WTO. More recently under the Trump administration, the U.S. has relied more heavily on Section 301 as a unilateral measure to promote what the administration perceives as fair trade and to eliminate discriminatory practices against U.S.-based companies.

This Section 301 Investigation was directed to investigate the effects of the French DST “and determine whether it is discriminatory or unreasonable and burdens or restricts United States commerce.” The December 2, 2019, USTR report on France’s DST found that “France’s DST discriminates against U.S. companies and is inconsistent with prevailing principles of tax policy and unusually burdensome for affected U.S. companies.” Recall that the USTR estimates that 17 of 27 of the companies subject to the French DST are U.S.-

286. Id.
288. According to the WTO, “Dispute settlement is the central pillar of the multilateral trading system.” WTO members have agreed that if they believe fellow-members are violating trade rules, they will use the multilateral system of settling disputes instead of acting unilaterally. For more on the WTO’s multilateral system of settling disputes, including timelines, see Understanding the WTO: Settling Disputes, WTO, https://www.wto.org/english/thewto_e/what_is_e/tif_e/displ_e.htm.
289. Andres B. Schwarzenberg, Section 301 of the Trade Act of 1974: Origin, Evolution, and Use, at 1, Cong. Rsch. Serv., R46604 (Dec. 14, 2020). Note that under the Trump Administration, the USTR has initiated Section 301 Investigations against China (on technology transfers and IP), the EU (on large civil aircraft), the EU (on the beef industry), Vietnam (import and use of illegal timber), France’s DST, and the DST of 10 trading partners. See Section 301 Investigations, U.S. TRADE REPRESENTATIVE, https://ustr.gov/issue-areas/enforcement/section-301-investigations/.
290. U.S. Trade Representative, Press Release: USTR Announces Initiation of Section 301 Investigation into France’s Digital Services Tax (July 10, 2019). The USTR held a public hearing on August 19, 2019, where ten witnesses testified and responded to questions from the interagency Section 301 committee. Witnesses included representatives of large U.S.-based digital companies such as Amazon, Google, and Facebook. Testimonies expressed concern regarding the French DST, and conveyed support of the U.S. initiative to conduct the investigation. See USTR Public Hearing, supra note 235, at 47-61.
291. U.S. Trade Representative, supra note 230, at 1. The report detailed that the DST applies retroactively, applies to gross revenue rather than income thereby not accounting for losses, and that international tax principles require a significant territorial nexus for companies to fall within a country’s corporate tax jurisdiction. Id. at 30-62.
based. On July 10, 2020, the USTR decided to take action in the form of an additional 25% tariff on products of France. The new tariff applies to 21 subheadings with an estimated trade value of approximately $1.3 billion of French goods, which include handbags, soaps, and make-up preparations. The result of the investigation demonstrates the potential for "tax wars" between competing jurisdictions. In this battle, a tax imposed by France on U.S.-based digital MNEs led to a punitive tax on French goods by the U.S.

The USTR’s probe into unilateral DSTs did not end with France. In a June 2020 notice, the USTR announced that it has initiated a Section 301 Investigation into the DSTs of ten U.S. trading partners: Austria, Brazil, the Czech Republic, India, Indonesia, Italy, Spain, Turkey, the U.K., and the EU. The announcement conveyed the U.S.’ determined position that DSTs are hostile measures that discriminate against U.S.-based companies. In January 2021, the USTR found that the DSTs of India, Italy, Turkey, Austria, Spain, and the U.K. discriminate against U.S. digital services companies. The growing wave of unilateral measures along with U.S. resistance to DSTs will exacerbate these conflicts and contribute to the ongoing tax wars over taxable revenues, particularly as economies struggle to financially recover from the COVID-19 crisis.

VI. U.N. PROPOSAL

In August 2020, the U.N. Tax Committee released its own proposal on the tax treatment of payments for digital services. The proposal is a draft of a new article 12B that would be added to the U.N. Model Taxation Convention which has been developed by a drafting group from thirteen developing States.

292. Id. at 26-27.
295. For a full list of the products subject to the added duties, see id. at annex B.
301. Id. at 1.
The U.N. released a revised draft of the new article 12B in October 2020. Similar to the OECD’s Pillar One, the U.N. Proposal provides source countries a new taxing right with respect to automated digital services. In contrast with the OECD approach, the U.N. Proposal would take the form of a gross (rather than net) income tax in which a jurisdiction would have taxing rights over a percentage of in-scope revenues.

According to the U.N. Proposal, liable companies can elect to pay the article 12B tax either through withholdings on gross income, or through a net income tax on their “qualified profits” from automated digital services at a rate provided in the domestic law of the source State. “Qualified Profits” are considered 30% of a company’s net income derived from automated digital services. Moreover, the U.N. Proposal does not recommend a new nexus nor does it require the application of thresholds by so significantly differing from Pillar One. According to the U.N. Proposal’s Commentary, the proposal intends to benefit developing countries, who “have limited administrative capacity and need a simple, reliable and efficient method to enforce tax imposed on income from services derived by non-residents.” The U.N. Proposal acknowledges the progress of the OECD BEPS Project and perceives new article 12B as a mechanism that works within present international tax principles (without setting forth principled reform). Article 12B would be adopted into the U.N. Model Tax Convention and into tax treaties as a safeguard against BEPS that is administered by developing countries.

VII. DIGITAL TAXATION AND COVID-19

The COVID-19 pandemic has had a significant impact on the world economy. According to World Bank projections, “the COVID-19 global recession will be the deepest since the end of World War II, with the largest fraction of economies experiencing declines in per capita output since 1870.” The World Bank estimates that the global economy contracted by 4.3% in 2020 because of the COVID-19 crisis. U.S. GDP in 2020 is estimated to have declined by 3.6%, while the EU economy will condense without complete
immediate recovery. Governments have struggled to cope with the loss of economic growth and financial toll of COVID-19 while searching for new sources of revenue to recoup immense losses. An April 2020 communication from the EC to the European Parliament was appropriately titled: “Using every available euro in every way possible to protect lives and livelihoods.” Taxing large digital MNEs may be an attractive path to attain such goals.

Through the onset of the COVID-19 crisis, the OECD has remained committed to its goal of achieving a timely consensus-based multilateral solution. The U.S.’ reluctance to agree to Pillar One and the growing number of unilateral actions have been obstacles to accomplishing these plans. Pascal Saint-Amans, director of the OECD Centre for Tax Policy and Administration, has expressed that reaching an agreement on a global consensus-based solution is becoming increasingly urgent as the number of governments considering unilateral measures continues to rise. The OECD stated that its Secretariat team is working “full steam” on the digital tax project, with meetings held remotely due to the COVID-19 health crisis. The Inclusive Framework has continued its work and negotiations have proceeded through the pandemic, although the timeline of reaching a political agreement has been postponed from 2020 to 2021.

Several G20 finance ministers have communicated the need to proceed with the international tax reform agenda. German finance minister Olaf Scholz has stated that it is important, even in a time of a global crisis, to end profit shifting and tax avoidance. Scholtz elaborated that Pillars One and Two would build a smarter and fairer global corporate tax framework to support the long-term economic recovery from COVID-19. Saudi finance minister Mohammed

315. Recall that the EU has vowed to push ahead with EU-wide action in the event that OECD negotiations fail. See Margrethe Vestager, supra note 215. Meanwhile, several countries, including Belgium and Brazil, have proceeded to propose unilateral DSTs in the midst of the pandemic. See La Chambre, Proposition de loi relative à la création d’une taxe provisoire (TSN) portant sur les produits générés par certaines activités des géants du numérique (May 29, 2020) (for the Belgian DST proposal); Câmara dos Deputados, PL 2358/2020, Institui a Contribuição de Intervenção no Domínio Económico Incidente sobre a receita bruta de serviços digitais prestados pelas grandes empresas de tecnologia (May 4, 2020) (for the Brazilian DST proposal).
316. Pascal Saint-Amans, The economy has changes, so must the tax, BUSINESS & INDUSTRY, Mar. 5, 2020, https://www.businessandindustry.co.uk/tax/the-economy-has-changes-so-must-the-tax/.
318. Id.
321. Id.
Al-Jadaan also described that international tax reform “is actually more relevant today than before, as countries start to recover from the crisis and start to think about means to ensure that they repay their debts; that they manage their debt to GDP; that they think about fiscal levers they have… So fixing this is actually essential.”

Note that COVID-19 has accelerated rather than hindered the growth of the digital economy because consumers increasingly rely on digital consumption and many employees worldwide are working from home. The OECD has also expressed that tax policy can contribute to covering the costs incurred by governments dealing with the COVID-19 crisis.

The OECD’s plans have also been challenged by the U.S.’ stern position against fundamental international tax reform. U.S. officials, including Secretary Mnuchin, have opposed Pillar One while expressing the need to focus on the COVID-19 crisis. Meanwhile, the U.S. continues to oppose DSTs and intends to retaliate if countries adopt unilateral measures. The U.S. has also advocated shifting the multilateral solution on international tax reform to 2021 due to the COVID-19 crisis and the 2020 U.S. presidential election, which has become the present timeline.

The U.S.’ call to delay the OECD tax reform was unsurprising considering its reluctance to depart from traditional tax norms and its opposition to measures that target U.S.-based MNEs. The U.S. is motivated to at least stall the international tax reform process in light of these interests. The unwillingness


325. Steven Mnuchin Letter to Finance Ministers, supra note 161.

326. Id.

327. See Schultz, supra note 164; OECD, supra note 94, at 9.

328. Recall that the U.S. originally favored implementing Pillar One solely as an optional “safe-harbor,” to the dismay of the OECD. See Steven Mnuchin Letter to Gurria, supra note 157.

329. Note that a few other entities have also called to delay the OECD tax reform due to the COVID-19 crisis. The United States Council for International Business wrote a letter to Secretary Mnuchin recommending postponing the OECD’s workstream on taxation of the digital economy for at least six months so that governments and taxpayers channel their resources towards addressing the COVID-19 crisis. See Letter from the United States Council for International Business to U.S. Secretary of the Treasury Steven Mnuchin (March 23, 2020), https://www.uscib-content/uploads/2020/03/Treasury-letter-3.23.2020.pdf. The National Foreign Trade Council wrote a letter to Secretary Mnuchin expressing that the OECD’s proposals can be negotiated at an “appropriate time in the future, and that the OECD needs to use its international tax policy expertise to help mitigate the economic damage of the pandemic.” See Letter from the National Foreign Trade Council to U.S. Secretary of the Treasury Steven Mnuchin (Mar. 27, 2020), http://www.nftc.org/default/Tax%20Policy/NFTC%20Letter%20on%20OECD%20Tax%20Policy%20Work%20During%20the%20Pandemic%20March2020.pdf. The Federation of German Industries (Bundesverband der Deutschen Industrie) called on the OECD to postpone the deadline of its digital agenda, stating that “it would be unreasonable to stick to the ambitious timetable to reach a political agreement.” See BDI, COVID-19: Tax measures to tackle the impact of COVID-19 (April 1, 2020), https://english.bdi.eu/publication/news/covid-19. Note that all of the abovementioned entities have stated that obtaining an OECD consensus is a critical goal, and that
to agree to reforming international tax norms may be detrimental to global reform efforts and will continue to trigger tax wars if no solution is achieved.\footnote{delaying the OECD deadline should not lead to implementing unilateral DSTs.}{330} Although the new Biden administration has expressed encouraging commitment to the OECD negotiations, core U.S. interests have not changed. If the U.S. persistently resists global tax reform, it may find itself alone in a world dominated by unilateral DSTs that target its digital companies.\footnote{An outcome described by OECD Secretary-General Angel Gurria. See OECD Secretary-General, Meeting of the Inclusive Framework on BEPS: Opening Remarks by Angel Gurria (July 1, 2020), https://www.oecd.org/about/secretary-general/meeting-of-the-inclusive-framework-on-beps-july-2020.htm.}{331} In the present state of affairs, Pillar One may be the best-case scenario for the U.S. because it would allocate only a residual amount of non-routine profits to market jurisdictions. Unilateral DSTs are the worst-case scenario because they ring-fence the digital economy and explicitly target U.S.-based companies. Achieving a multilateral solution through the Inclusive Framework is the optimal way to prevent unilateral measures and to promote repealing existing DSTs.\footnote{An outcome that may force the U.S. to enact punitive measures against every jurisdiction that enacts a DST.}{332} Without a multilateral framework, the U.S. may be prompted to investigate more of its trade partners and to retaliate against discriminatory taxes. The COVID-19 crisis makes unilateral measures greatly appealing, and several jurisdictions, including the EU, intend to enact unilateral measures if the OECD cannot produce a consensus-based solution.\footnote{Note that several administrations have agreed to withdraw or reevaluate their DSTs in the aftermath of an OECD-led multilateral consensus. This includes the French Digital Tax Bill. See @BrunoLeMaire, Twitter (Apr. 12, 2019), https://twitter.com/BrunoLeMaire/status/111663054599311431 (stating that “once we have a global consensus, France will withdraw its national tax”); Austrian Digital Tax Act, supra note 206 at Sec. 8(2).}{333} The U.S. ought to advance Pillar One and encourage a timely multilateral agreement to avoid a reality where unilateral DSTs become the international tax norm.\footnote{2020 EC Communication, supra note 212, at 15.}{334}
VIII. NEW NEXUS PROPOSAL

A. Eliminating the Global Revenue Threshold

Market jurisdictions are eager to reform international tax norms and to tax revenues of MNEs irrespective of physical presence in their jurisdictions. On the opposite end, the U.S. is reluctant to depart from current international tax norms in the interest of protecting its companies and its own tax receipts. A global consensus is important to prevent international tax wars and to ensure that profits are attributed to jurisdictions in which they are earned. A multilateral solution is particularly significant in an economic environment where physical presence does not necessarily indicate economic activity.

This section proposes adopting the OECD’s Pillar One approach, while modifying its threshold-based application incorporated in Amount A. The proposal can be summarized as follows: (1) Eliminating the global revenue threshold (€750 million); (2) Applying tax nexus based on market thresholds; (3) Establishing a de minimis amount for market thresholds. Such a multilateral approach would be more equitable, preserving the core Pillar One elements sought by the Inclusive Framework while eliminating a global revenue threshold that targets U.S.-based companies.

A notable similarity between the OECD’s Pillar One and unilateral DSTs is that both apply a new taxing right subject to satisfying two cumulative thresholds. The first is a size-limiting global revenue threshold that corresponds to an MNE’s annual consolidated gross revenues. An MNE is subject to the tax only if it exceeds annual revenues in this amount. The OECD’s Pillar One suggests a €750 million threshold or greater, and unilateral DSTs have largely established similar threshold ranges. These global revenue thresholds apply the new tax only to a select group of exceptionally large MNEs.

The second threshold is a market threshold, providing that tax nexus would exist only if an MNE exceeds specified revenues or sales in the market jurisdiction. The market threshold indicates the MNE’s substantial involvement in the economy of the market jurisdiction, not dependent on physical presence. Market revenue thresholds in unilateral DSTs vary widely, from €3 million in Spain to £25 million in the U.K as an example. The OECD has noted that such a threshold could be adjusted to the size of the market, and to ensure the benefit also reaches smaller jurisdictions and developing economies.

335. Recall that according to Pillar One, a new taxing right is allocated to market jurisdictions through new nexus and profit allocation rules. The new nexus rule would apply in all cases where a business has a sustained and significant involvement in the economy of a market jurisdiction and would be based on global revenue and market thresholds. See OECD, supra note 94, at 12-15; OECD, supra note 110, at 5, 7-8.
336. OECD, supra note 94, at 62.
337. The nexus would apply irrespective of physical presence in the market jurisdiction.
338. Spanish Digital Services Tax, supra note 206.
339. HMRC Digital Services Tax, supra note 206.
340. OECD, supra note 94, at 65.
This section proposes implementing a multilateral approach without global revenue thresholds and applying the new tax nexus based on market thresholds. Furthermore, it proposes that the market thresholds would be subject to a global de minimis amount determined at the OECD level. Relying on market thresholds will correct significant flaws of Pillar One while maintaining the autonomy of tax administrations within a multilateral solution.

A €750 million global revenue threshold (or greater) significantly narrows the scope of any approach that aims to provide a long-term solution to the tax challenges of digitalization. Global revenue thresholds profoundly limit Pillar One and apply the new tax only to a small subset of businesses. With a global revenue threshold, the Pillar One outcome would not substantially differ from a DST because both would only target extremely large and mostly U.S.-based MNEs. In addition, a size-limitation narrows the base of the new tax while triggering an undesired “cliff” effect for companies falling just in or out of the threshold. Cliffs effects in income taxation have been frequently criticized by legal scholars because they arbitrarily leave taxpayers in worse economic positions than if they had earned less revenue. For example, consider a 3% tax applying to MNE groups exceeding €750 million of annual revenues. This tax leaves a company with €751 million of annual revenues worse off than a company with €749 million of annual revenues, because only the former is subject to the tax. In fact, because a company earning €751 million of annual revenues would be liable to pay €22.53 million in taxes (under a 3% DST), it would be worse off post-tax than any company earning between €727.47 million and €750 million of annual revenues. Such cliffs contravene vertical equity because the higher-earning taxpayer would be left in a worse economic position post-tax than the lower-income taxpayer. The global revenue threshold is not progressive, and this unfair result would stimulate tax planning and income distortions to avoid the tax liabilities created by the cliff.

Furthermore, the global revenue threshold does not indicate significant and sustained involvement in the economy of a market jurisdiction. Substantial involvement is indicated solely through the market threshold. The global revenue threshold serves only to target exceptionally large companies, preventing the implementation of equitable international tax reform. The examples below

341. The Pillar One Blueprint recognizes the problematic nature created by a “cliff-edge” effect of a single threshold. This issue, however, is emphasized with respect to the development of a domestic business exemption in determining the fixed return for the marketing and distribution safe harbor, and not when considering the €750 million global revenue threshold. Id. at 135-137.


343. For the purposes of this example, disregard the application of a market threshold.

344. Viswanathan, supra note 343, at 955-56.

345. Pillar One provides that setting a threshold below €750 million would lead to substantial compliance burdens for both private companies and tax administrations, without matching benefits in profit reallocations. See OECD, supra note 94, at 22, 62. The OECD does not address whether there is a material difference between a €750 million-earning company, and a company earning slightly less (other than reporting requirements). The OECD also does not address whether there are possible violations of nondiscrimination and vertical equity.
illustrate the flaws of the global revenue threshold, and the advantage of relying on market thresholds to establish the new taxing right. In examples 1-3, assume that the global revenue threshold, determined at an OECD level, is €750 million. Also assume that the market revenue threshold of Country F is €25 million. To be subject to the new tax in Country F, an MNE group must therefore report annual revenues of at least €750 million, and at least €25 million of revenues in Country F. If both thresholds are satisfied, a portion of the deemed residual (non-routine) profits of the relevant MNE would be allocated to Country F. Assume also that all other Amount A criteria are met.

Example 1: DigitalCorp is a U.S.-based company that does not have a physical presence in Country F. DigitalCorp reports €755 million in revenues for the relevant financial year. DigitalCorp’s revenues in Country F are €28 million. DigitalCorp would be subject to the new tax in Country F, because it meets both thresholds: the global revenue threshold (over €750 million) and the market revenue threshold (over €25 million in Country F).

Example 2: CompuCorp is a U.S.-based company that does not have a physical presence in Country F. CompuCorp reports €2 billion in revenues for the relevant financial year. CompuCorp’s revenues in Country F are €10 million. CompuCorp would not be subject to the new tax in Country F because it does not meet Country F’s market revenue threshold. This is despite CompuCorp’s global revenues which significantly exceed both the OECD’s global revenue threshold and DigitalCorp’s annual revenues. This result is sensible because CompuCorp’s market activity in Country F does not rise to the deemed level of substantial economic engagement that warrants tax liability irrespective of physical presence. The scale of CompuCorp’s global revenues is irrelevant, as long as it does not substantially engage in the economy of Country F. In this example, CompuCorp does not meet Country F’s market threshold and is therefore not deemed to be substantially engaged in its economy.

Example 3: OnlineCorp is a U.S.-based company that does not have a physical presence in Country F. OnlineCorp reports €600 million in revenues for the relevant financial year. OnlineCorp’s revenues in Country F are €56 million. Although OnlineCorp meets the market revenue threshold of Country F, it will not be subject to the tax because its global revenues do not exceed the €750 million amount required by the global revenue threshold.

The outcome of example 3 illustrates the unreasonable results under a global revenue threshold. Even though OnlineCorp is clearly substantially engaged in the economy of Country F, its business activities do not give rise to tax liability because its annual global revenues do not exceed €750 million. Compare the outcome of DigitalCorp in example 1 to OnlineCorp in example 3. In example 1, DigitalCorp has tax liability in Country F because it satisfies both thresholds, including the €25 million market threshold. In example 3, although

346. The examples were originally presented by the author in Assaf Harpaz, OECD Unified Approach: Nexus, Scope, and Coexisting with DSTs, 96 Tax Notes Int’l 909, 910 (2019).
347. Id.
348. Id.
349. Id.
OnlineCorp earns double the revenues of DigitalCorp in Country F (€56 million versus €28 million), OnlineCorp is not subject to tax in Country F simply because its global revenues do not exceed €750 million. This yields an irrational outcome that does not allocate taxing rights based on an MNE’s substantial involvement in the market jurisdiction.\footnote{Several companies fall into the example 3 scenario. In the case of the French DST, this includes streaming service Deezer. See U.S. Trade Representative, supra note 230, at 22-23.}

In example 3, OnlineCorp is significantly involved in the economy of Country F and ought to incur a tax liability. However, it is saved by the €750 million global revenue threshold, which considerably narrows the tax base. The size-limiting threshold does not necessarily indicate economic involvement in a market jurisdiction, as shown in example 3. A global revenue threshold thus creates an unwanted cliff effect, arbitrarily applies to a limited set of companies, and fails to indicate substantial involvement in the economy of a market jurisdiction. Eliminating the global revenue threshold would address the legitimate discrimination concern voiced by the U.S., because a substantial portion of digital MNEs targeted by a €750 million threshold are U.S.-based.

B. Relying on Market Thresholds

This Article recommends adopting a multilateral solution without a global revenue threshold and suggests determining tax nexus based on market thresholds. The new taxing right would thereby be assessed based on the revenue of a foreign company in a particular market jurisdiction. The market threshold would indicate sustained and significant involvement in the market jurisdiction, with no regard for the size-limiting global revenue threshold. Consider several elements that underline this proposal. First, market thresholds may be adjusted to the size of the market: the larger the size of the market, the higher the degree of involvement generally required to establish tax nexus. The market threshold therefore ought to rise respectively with the size of the market jurisdiction. Consider for example France and Estonia, both members of the OECD and the Inclusive Framework. The population of France is 67 million,\footnote{Usually resident population on 1 January, EUROSTAT (Oct. 10, 2019) (EC), (under “database,” “population and social conditions,” “population”), https://ec.europa.eu/eurostat/data/database [hereinafter Eurostat].} and its nominal GDP is $2.8 trillion.\footnote{France: Gross domestic product, current prices, IMF World Economic Outlook Database (2020).} Estonia’s population is only 1.3 million,\footnote{Eurostat, supra note 352.} and its GDP is $32.7 billion.\footnote{Estonia: Gross domestic product, current prices, IMF World Economic Outlook Database (2020).} These broad differences could be reflected by adjusting the market thresholds to match the size of the relative markets to be sensitive to GDP and population.\footnote{The OECD mentions the possibility of adjusting the market revenue threshold based on the market’s GDP, but acknowledges that using this metric could add substantial complexity. See OECD, supra note 94, at 67. GDP is one of several possible indicators that could be used to determine the market threshold, which ought to be determined by the market.} Second, market thresholds would be determined unilaterally on a country-
by-country basis, rather than on an OECD level. In so, this proposal provides much greater jurisdictional autonomy than the proposed Pillar One. Applying a threshold of deemed sustained and significant involvement is a decision best made by independent tax administrations. A unilateral determination preserves jurisdictional autonomy to implement and maintain independent taxing rules within a larger multilateral approach. Tax administrations ought to be able to perform calibrations to fit their market sizes and satisfy administrative needs. The objective is to permit flexible application of an equitable threshold that could encourage jurisdictions to withdraw DSTs in favor of the autonomy enabled by the multilateral approach. Such leeway permits jurisdictions to select the size of their tax base while eliminating the unwanted effects of the global revenue threshold. A market threshold-based system would favor EU Member States and other States which have enacted DST regimes seeking to collect tax revenue based their administrative needs.356

C. Establishing a Global De Minimis Amount

The broad discretion afforded to States in setting market thresholds should not be unlimited, however. This Article recommends that market thresholds be subject to a global de minimis amount established on an OECD level. The global de minimis amount would effectively serve as a small-seller exemption from the new nexus.

The OECD’s Pillar One, akin to many DSTs, suggests a €750 million global revenue threshold that leaves most businesses unaffected, including small sellers. Note that both Pillar One and DSTs are not designed to specifically protect small sellers; companies earning revenues in the hundreds of millions are exempt from tax liability yet cannot be reasonably considered “small.” Nevertheless, small businesses may face exposure to tax liability if global revenue thresholds are wholly eliminated. A global de minimis amount for market thresholds would function as a small seller exemption to protect smaller companies. For example, assume that the market revenue threshold for Country S is €2,000, unilaterally determined by Country S. Assume further that SmallCorp, a U.S.-based start-up company without a physical presence in Country S, reports €20,000 in revenues for the relevant financial year. SmallCorp’s revenues in Country S are only €2,100. Without a global revenue threshold, SmallCorp would be liable to pay the new tax, even though its revenues in Country S are only €2,100. This would be an unreasonable result that does not indicate a sustained and significant involvement in any economy, and would also create undesirable compliance costs for smaller companies. This problem can be resolved by instituting a global de minimis amount on market thresholds. The de minimis amount would function as a limit on the unilateral discretion of tax administrations; preventing arbitrary and excessive taxation of small sellers.357 This means that the country-by-country threshold determination

357. OECD, supra note 94, at 8.
will be subject to a predetermined de minimis amount. The de minimis amount would be a minimum amount, agreed upon at the OECD level. Countries would be permitted to exceed but not fall below the amount when setting their thresholds.

In addition, to eliminate a cliff effect for market thresholds, MNEs ought to be taxable for every dollar above the market threshold rather than the entire amount once the threshold is met, a common practice in income tax design. Consider that market threshold of DST regimes can incorporate a cliff effect, because taxable enterprises are often fully taxable on all revenue if the market threshold has been satisfied (e.g. €25 million) and not liable at all if falling just short. An ideal market threshold regime would tax every dollar above the threshold—similar to income tax brackets—thereby eliminating the cliff effect. Under such a system, taxpayers exceeding the threshold are not worse off than those falling just short of it, and vertical equity remains observed. Assume, for example, that the global de minimis amount for market revenue is $100,000, and that Country T adopts the de minimis amount as its market threshold. QCorp, a foreign enterprise, earns $105,000 of revenue in Country T, and does not have physical presence in that country. Under the proposal set forth in this section, QCorp would not be taxable on its first $100,000 of revenue in Country T and would be taxable for every dollar above $100,000. A de minimis threshold would therefore work as a small-seller exception and would tax prevent tax authorities from targeting companies that are not profitable in market jurisdictions, such as smaller start-up companies.

This proposal attributes taxing rights to the market jurisdiction by applying the Pillar One taxing right based on market thresholds, subject to a global de minimis amount. The proposal also reduces profit shifting opportunities, because a tax nexus would be established in market jurisdictions irrespective of physical presence. MNEs substantially engaging in economic activity in the market would be caught by the new taxing right, while the market thresholds would be determined by independent administrations. As a result, profits of MNEs would be attributed, with more accuracy, to the jurisdiction in which they were earned. Moreover, eliminating the global revenue threshold as well as unwanted cliff effects greatly reduces tax planning opportunities. Avoiding the new taxing right by dodging a threshold or distorting income would be far more difficult.

Admittedly, implementing this approach on an OECD level may be

358. The de minimis threshold amount may bear resemblance to VAT registration exemptions provided in OECD countries. The higher-end exemption thresholds implemented by the U.K. (£85,000; approximately $117,000), Japan (¥10 million; approximately $96,000) and Switzerland (CHF 100,000; approximately $113,000) can serve as a reference for the possible de minimis amount. If the OECD desires to limit compliance costs and administrative burdens, this number could also be much higher. In any event, it ought to be determined without discrimination. See VAT registration: When to register, HMRC, https://www.gov.uk/vat-registration/when-to-register; Section 3. Taxes in Japan 3.6 Overview of consumption tax, JAPAN EXTERNAL TRADE ORGANIZATION https://www.jetro.go.jp/en/invest/set_up/section3/page6.html; Foreign Companies, SWITZERLAND FEDERAL TAX ADMINISTRATION, https://www.estv.admin.ch/es/t/en/home/mehrwertsteuer/fachinformationen/steuerpflicht/leistungen-durch-auslandische-unternehmen.html. A de minimis amount could also be adjusted for economy size (e.g. GDP), although such a threshold will require an internationally agreed-upon metric and constant calibrations.

359. Or other applicable currency.

360. Note that this is not the case with the U.K. DST, where £25 million is deducted before the 2% tax is applied. See HMRC Digital Services Tax, supra note 206.
challenging because it requires further substantial negotiation within the Inclusive Framework, and eliminates the targeting of U.S.-based companies. Digital tax measures, both unilateral and multilateral, are often popular precisely because they target the revenues of large U.S.-based companies. Some OECD countries may be reluctant to support an approach with a broad tax base until and unless the U.S. supports international tax reform in general. This proposal serves as a suggested compromise between the U.S. and other OECD Members. The proposal would equitably allocate taxing rights to market jurisdictions while reducing the tax gap between digital and non-digital companies without discrimination.

IX. CONCLUSION

This Article examined the tax challenges arising from digitalization and the leading approaches that aim to reform the international tax framework. It evaluated the OECD’s Pillar One against unilateral DSTs and analyzed the obstacles to achieving a global consensus-based solution. It argued that international tax reform ought to be implemented through a multilateral approach and asserted that unilateral measures will leave the international tax framework in disarray. Furthermore, it recommended a multilateral solution without global revenue thresholds that explicitly target U.S.-based companies. The Article proposed applying the new tax nexus through market thresholds and subject to a global de minimis amount.

These are critical times in which governments are engaging in growing tax wars over revenue sources. The OECD has been slow to adapt the international tax system to the digital era, thereby prompting unilateral action by discontented tax administrations. The OECD faces a great challenge of achieving a consensus-based solution within an Inclusive Framework numbering 137 Member States. This challenge is profoundly exacerbated by the COVID-19 pandemic in which economies are suffering, the need for tax revenue is immediate, and unilateral measures are highly appealing. A timely consensus-based solution is imperative and must address both the U.S.’ concerns and the prevalence of unilateral regimes already in force.