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Taxing the Digital Economy in Developing Countries

A Legal Comparison Between OECD's Pillar One and UN's Article 12B

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Summary

The taxation of the digital economy has been the leading topic in the area of international taxation in the last decade. The ongoing digitalisation has introduced new business models which have led to increased pressure on the international tax system, which was established in the 1920s. As today's international tax rules have not kept pace with the unique conditions linked to digital business models, there is a global view that the international tax system needs to be reformed.

To deal with this global phenomenon of digitalisation, two major international institutions have put forward proposals that aim to solve the tax challenges arising from the digital economy. In October 2020, the OECD/G20 Inclusive Framework published the Report on Pillar One Blueprint. In August 2020, the UN Subcommittee on Tax Challenges Related to the Digitalization of the Economy proposed a new tax treaty rule: Article 12B on income from automated digital services. In April 2021, a final draft of Article 12B was adopted which will be incorporated in the 2021 UN Model.

The purpose of this thesis is to examine and compare the OECD's Pillar One and the UN's Article 12B in order to identify and analyse both similarities and differences between the two proposals. Further, the thesis aims to determine which of the proposals is in favour of developing countries. For this purpose, the concept of inter-nation equity has been applied as an evaluative criterion.

The thesis concludes that Pillar One and Article 12B have vital differences and few similarities. From the concept of inter-nation equity, this thesis argues that Article 12B is in favour of developing countries as it offers a less complex solution which may also lead to more tax revenues being reallocated to developing countries. The thesis concludes that the international tax system has historically disadvantaged developing countries. Therefore, reaching a

sustainable global solution requires that countries' different needs and capacities are taken into account.

Sammanfattning

Beskattning av den digitala ekonomin har varit en av de mest centrala delarna i den internationella skattekontexten under det senaste decenniet. Digitaliseringen har gett upphov till nya affärsmodeller som har lett till ett ökat tryck på det internationella skattesystemet som inrättades på 1920-talet. Eftersom dagens internationella skatteregler inte har anpassats till den digitala affärsmiljön, finns det en globalt samstämmig uppfattning om att det internationella skattesystemet behöver reformeras.

För att hantera det globala fenomenet med digitaliseringen har två internationella institutioner lagt fram förslag som tar sikte på beskattningen av den digitala ekonomin. I oktober 2020 publicerade OECD/G20:s inkluderande ramverk den senaste rapporten avseende Pelare 1. I augusti 2020 föreslog FN:s underkommitté för skatteutmaningar relaterade till digitaliseringen av ekonomin en ny skatteavtalsregel: Artikel 12B om inkomster från automatiska digitala tjänster. I april 2021 antogs det slutliga utkastet av Artikel 12B som kommer att införlivas i FN:s modellavtal.

Syftet med denna uppsats är att undersöka och jämföra OECD:s Pelare 1 och FN:s Artikel 12B för att identifiera och analysera likheterna och skillnaderna mellan de två förslagen. Vidare är syftet att avgöra vilket av förslagen som gynnar utvecklingsländer. För detta ändamål kommer begreppet *inter-nation equity* att användas som ett utvärderingskriterium.

Uppsatsen drar slutsatsen att Pelare 1 och Artikel 12B har vitala skillnader och få likheter. Utifrån begreppet *inter-nation equity* argumenterar denna uppsats för att Artikel 12B gynnar utvecklingsländer, eftersom den erbjuder en mindre komplex lösning som också kan leda till att fler skatteintäkter omfördelas till utvecklingsländer. I uppsatsen dras slutsatsen att det internationella skattesystemet historiskt sett har missgynnat

utvecklingsländer. För att uppnå en långsiktig global lösning krävs därför att länders olika behov och förutsättningar beaktas.

Preface

I would like to express my sincerest gratitude, firstly, to my supervisor Yvette Lind for her guidance and support during this process. She has inspired me to choose this topic and learn about a new dimension of international tax law.

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Finally, thank you Haris for your unconditional love. I look forward to discovering life with you.

Malmö in May 2021

Elma Hadzovic

Abbreviations

ADS	Automated Digital Services
ALP	Arm's Length Principle
BEPS	Base Erosion and Profit Shifting
CFB	Consumer Facing Businesses
G20	Group of Twenty Finance Ministers and Central Bank Governors
HDI	Human Development Index
ICT	Information and Communication Technology
IF	Inclusive Framework
IMF	International Monetary Fund
MNE	Multinational Enterprise
OECD	Organisation for Economic Co-operation and Development
OECD Model	OECD Model Tax Convention on Income and on Capital
OEEC	Organisation for European Economic Co-Operation
PE	Permanent Establishment
UN	United Nations
UN Model	United Nations Model Tax Convention Between Developed and Developing Countries
UNDP	United Nations Development Programme

1 Introduction

1.1 Background

In the recent decade, taxation of the digitalised economy has been the leading topic on the global tax agenda. The digitalisation has led to new opportunities for global growth and revolutionised the way businesses operate globally. The new business models are operating in market jurisdictions in a fundamentally different manner than at the time international tax rules were designed and established. Today, business activities cross borders and are carried out with high-speed while not necessarily having a physical presence in the market jurisdiction. Due to the nature of these new business models, the digitalisation has led to increased pressure on the existing international tax system.

Two international tax rules pose a challenge to the taxation of the digitalised economy. The first is the permanent establishment (PE) rule that allocates taxing rights to a country where a multinational enterprise (MNE) creates a sufficient physical presence. The second is the profit allocation rule, based on the arm's length principle (ALP), that allocates profits based on value created. In the current digital environment, MNEs can operate without creating a physical taxable presence in a market jurisdiction and use business models that challenge the notions of where and how value is created. As today's international taxation rules have become exponentially outdated, there is a global view that the international tax system needs to reform.[1]

The Organisation for Economic Cooperation and Development (OECD) has been the leading figure in the work of addressing the challenges of the digital economy.[2] Taxation of digital companies has been a key area of focus of the Base Erosion and Profit Shifting (BEPS) project, which was initiated by the

[1] OECD, Addressing the Tax Challenges of the Digital Economy, Action 1—2015 Final Report (Paris: OECD, 2015) (hereinafter "OECD Action 1"), p. 98-101; UN, Handbook on Selected Issues in Protecting the Tax Base of Developing Countries (New York: UN, 2017) (hereinafter "UN Handbook 2017"), p. 501 and p. 504; Rukundo (2020) p. 7.
[2] See for example W. Blum (2015); Olbert & Spengel (2017); Greil & Wargowske (2019).

OECD/G20 countries in order to prevent and address the growing issue of tax avoidance and tax evasion by MNEs.[3] In 2016, the OECD established the OECD/G20 Inclusive Framework that brings together non-member countries and jurisdictions to discuss and collaborate on the challenges and implementation of the BEPS project. In October 2020, the OECD/G20 Inclusive Framework released the Report on Pillar One Blueprint (Pillar One).[4] The report aims to reach a global agreement on adapting the allocation of taxing rights on business profits in a way that will expand the taxing rights of market jurisdictions.[5]

While the OECD is working towards achieving a global consensus on a unified approach, another policy actor in the international tax arena has introduced an alternative solution – the United Nations and its Committee of Experts on International Cooperation in Tax Matters (UN Tax Committee). Since the great majority of the UN member states are neither members of the OECD or the G20, the UN Tax Committee has an important role to play towards ensuring increased international cooperation in tax matters to the benefit of both developed and developing countries. It has a key role to play to ensure the active participation of developing countries, especially the least developed ones, in relevant activities.[6]

In August 2020, the UN Subcommittee on Tax Challenges Related to the Digitalization of the Economy (the "UN Subcommittee") proposed a new tax treaty rule: Article 12B on income from automated digital services. The revised draft of Article 12B was published in October 2020.[7] In April 2021,

[3] OECD, Action Plan on Base Erosion and Profit Shifting (Paris: OECD, 2013).
[4] OECD Action 1; OECD, Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint OECD (Paris: OECD, 2020) (hereinafter "Pillar One").
[5] Pillar One p. 11.
[6] UN, Strengthening the UN Role in International Tax Cooperation, available at https://www.un.org/development/desa/financing/what-wedo/ECOSOC/taxcommittee/thematic-areas/strengthening-UN-role-international-tax-cooperation (last visited Feb. 20, 2021).
[7] The 20th Session of the Committee of Experts on International Cooperation in Tax Matters (October 20-23 and 26-29, 2020), E/C.18/2020/CRP .41, Co-Coordinator's Report (hereinafter "The 20th Session Report"), p. 5 and p. 9 f.

the UN released the final draft of the proposal which will be incorporated in the UN Model[8].[9]

The new Article 12B grants additional taxing rights to source countries in respect of income arising from automated digital services, even though the provider of the service may not have a PE in the source country. The UN proposal[10] is radically departing from OECD's Pillar One and has been praised for its practical and simple approach.[11] With the UN proposal significantly departing from the OECD's view, the question arises if OECD's Pillar One approach under the Inclusive Framework is in the interest of developing countries.

1.2 Purpose and Research Questions

The main purpose of this thesis is to examine the OECD's Pillar One and the UN's Article 12B on addressing the issue of taxation of the digitalised economy. The thesis aims to, through a comparative analysis, identify and discuss the similarities and differences of these legal instruments. The thesis is written from the perspective of developing countries, and therefore the focus will be on whether the proposals consider developing countries' interests and opportunities to administer and implement the instruments. As a result of this, I will further discuss alternative best practices for developing countries on the taxation of the digital economy.

To fulfil the purpose of this thesis, the following questions will be examined:

- What tax challenges does the digital economy give rise to and what proposals are currently discussed at an international level?

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[8] United Nations Model Tax Convention Between Developed and Developing Countries.

[9] The 22nd Session of the Committee of Experts on International Cooperation in Tax Matters (April 19-28, 2021), E/C.18/2021/CRP .1, Co-Coordinator's Report (hereinafter "The 22nd Session Report").

[10] I will continue to use the term proposal as the draft of Article 12B was a proposal while writing this thesis.

[11] See Rawal (2020).

- What are the similarities and differences between the OECD's Pillar One and the UN's Article 12B with regard to legal wording and factual outcome when applied?
- Which of the proposals is in favour of developing countries? For this purpose, the concept of inter-nation equity will be applied.

Two practical cases are applied to the descriptions and analyses of these legal instruments as a way of addressing the issue more pedagogically.[12] The two cases read as follows:

Case 1: An MNE resident in country A offers advertisements on a social media platform. A company resident in country B pays the non-resident MNE for an advertisement on the social media platform. In country C, a user on the social media platform is the target of the advertisement.

Case 2: An MNE resident in country A collects data based on the real-time location of the users located in country B. A company resident in country C pays the non-resident MNE for the user data based on the real-time location of the users.

1.3 Method and Materials

In order to achieve the purpose of the thesis, a traditional legal method is applied. The traditional legal method is based on the use of the generally accepted sources of law in order to interpret and systematise the applicable law and establish the current legal situation.[13] In a strict sense, the method means that guidance is only sought in legislation, preparatory work, case law and legal doctrine. The thesis takes its starting point by using the traditional legal method[14], whereas the principles and concepts of the international tax system have been analysed and examined. In this part of the thesis, literature

[12] The cases will be examined in section 3.4. and 4.4.
[13] Sandgren (2018) p. 48 f.; Kleineman (2018) p. 21.
[14] The thesis will rely on the traditional legal method as stated by Jan Kleineman.

and academic writings by legal scholars have been examined. Among these, I have used Junita Sagarajans important contribution *Double Taxation and the League of Nations* and Michael Kobetskys *International Taxation of Permanent Establishments: Principles and Policy*. The choice of literature is based on the prominence of these authors and them being frequently quoted by other legal scholars. When describing the troubling role of tax treaties, I have also used different studies of legal scholars that have contributed to important research on the subject. In this part, publications by for example Tsilly Dagan, Martin Hearson and Veronika Daurer have been used. This is motivated as these authors are among the few ones that have written about the subject, and them being frequently cited in other publications.

As the purpose of the thesis is to examine international tax law, the search of material is also extended to include non-binding regulations, so-called soft law. When describing the tax challenges arising from the digital economy, and examining the proposals, I have used reports and other publications from the OECD and the UN. Instruments from these organisations are not an established source of law; however, they constitute soft law which is an important source of law in international tax law. Soft law constitutes of norms that are not thought of as law *per se*, but as norms that seem to have effects that evoke a legal process or form.[15] Due to the fact that the material used is of a hard law nature and subsequently not binding to individual states, the value of the material as a source of law can be discussed.[16]

As the material from the OECD and the UN is used as a primary source in this thesis, the purpose of the thesis would not be achievable by a strict use of the traditional legal method. This thesis therefore also uses a method that can be described as the legal analytical method. This method analyses the law, perhaps based on a certain value, and recognises that there may be several solutions to a legal problem. The method seeks to analyse the law, rather than to establish it. Using this method, the law is analysed with a wider array of

[15] Christians (2007) p. 6.
[16] For a discussion of the value of OECD material as a source of law, see Tjernberg (2018).

sources than when using the traditional legal method, and therefore the legal analytical method allows using material more freely. These materials can for example be soft law, recommendations and regulations from international organisations.[17]

Both the OECD and the UN have developed and refined various soft law governance mechanisms. It is important to consider that these non-binding instruments do not lack legal value. The OECD and the UN have played and are still playing an influencing role in shaping the current international tax regime.[18] In tax scholarship, especially in the international context, the most used guidance consists of soft law. Even though there is no formal supranational tax body through which countries hierarchically bind themselves, some tax practices and norms are or are becoming supranational as they are perceived to be binding in some way on countries. Especially soft law by the OECD has influenced and reshaped the international tax system.[19]

The impact of OECD on international tax matters has been so influential in the context of international taxation that some have referred to the organisation as a *de facto* world tax organisation. Through the BEPS project, the OECD has produced agreements and soft law on issues in a short period of time that have considerably reshaped international taxation. Even though countries are not required to obey guidelines and recommendations by the OECD, as it is considered to be soft law, they will comply with it.[20] The OECD has itself pointed out that "the BEPS outputs are soft law legal instruments. They are not legally binding but there is an expectation that they will be implemented accordingly by countries that are part of the consensus."[21]

[17] Sandgren (2018), p. 50-52.
[18] Chaisse & Xueliang (2018) p. 493 f.; Christians (2007) p. 8; Binder & Wöhrer (2019) p. 4 f.
[19] Chaisse & Xueliang (2018) p. 494; Christians (2007) p. 2.
[20] Christians (2007) p. 6 f.; Picciotto (2018) p. 44; Chaisse & Xueliang (2018) p. 466 and p. 494.
[21] OECD, BEPS-Frequently Asked Questions: Top 10 FAQs About BEPS, OECD, available at https://www.oecd.org/ctp/beps-frequently-asked-questions.pdf. (last visited Mar.15, 2021).

Soft law has also become “hard law” and therefore binding on a national level. The model conventions from the OECD and UN constitute the base for most of the world’s concluded tax treaties.[22] Tax treaties become hard law and binding upon the states that conclude them. In Sweden, tax treaties become binding when they are incorporated through domestic legislation.[23] Further, soft law produced by the OECD’s BEPS-project in the form of several actions and recommendations have become binding upon states in the European Union through the adoption of the Anti-Tax Avoidance Directive.[24]

1.4 State of Research

As both of the proposals that are examined were published during the fall of 2020, there is naturally less doctrine to find at this time. There are currently a few articles discussing both Article 12B and the Pillar One.[25] These articles have, together with the public comments received on Article 12B, been used in the comparative analysis of the proposals. The articles that I have found on the subject do not contain an extensive overview of the key features of Pillar One and Article 12B, and the proposals are not analysed considering the historical structure of the international tax regime. Further, I have not found another thesis written on this subject. This thesis therefore contributes to the research field through an in-depth comparative analysis of the key features of Pillar One and Article 12B, and by using the concept of inter-nation equity, determining which of the proposals is in favour of developing countries.

[22] Kobetsky (2011) p. 50 f.; Chaisse & Xueliang (2018) p. 471; Avi-Yonah (2019) p. 51.
[23] Dahlberg (2020) p. 281.
[24] Council Directive (EU) 2016/1164 of 12 July 2016 Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market.
[25] See for example Astuti (2020); Chand & Vilaseca, ”The UN Proposal on Automated Digital Services: Is It in the Interest of Developing Countries?”, Kluwer International Tax Blog, Wolters Kluwer, 5 March 2021.

1.5 Developing Countries

1.5.1 Definition

Countries have for a long time been placed in groups to try to better understand their social and economic outcomes. The most widely known example thereof is that of labelling countries as either developed or developing.[26] The terms became more commonly used in the 1960s to characterise countries, particularly in the context of policy discussions on transferring resources from richer countries to poorer countries.[27]

There have been discussions on where to draw the line between developed and developing countries. In the absence of a generally accepted classification system, some international organisations have used membership of the OECD as the main criterion for developed country status.[28] The OECD has itself not used such a country classification system, however, the preamble to the OECD Model Convention from 1961 includes a reference to the belief of the contracting parties that "economically more advanced nations should co-operate in assisting to the best of their ability the countries in process of economic development."[29]

When classifying countries according to their development, there is no universal criteria that is generally accepted. Various international organisations use several different measures and criteria to determine countries according to their development. The most famous definitions can be found in the United Nations Development Programme (UNDP), the World Bank, the International Monetary Fund (IMF) and the World Trade Organization (WTO).[30]

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[26] I recognise that a classification system based on two categories does not capture the diversity in development outcomes across countries and that it is a restrictive challenge to adequately classify countries into categories.
[27] See Pearson (1969).
[28] Nielsen (2011) p. 4.
[29] Convention on the Organisation for Economic Co-operation and Development, Paris, 14 December 1960, preamble.
[30] Nielsen (2011) p. 3 and p. 7 f.

For the purpose of this thesis, the terminology will follow the development taxonomy used by the UNDP. This is motivated by the decision of using a definition that is recognised in the UN as the thesis will examine the proposal that the UN has put forward to address the challenges of taxing the digital economy. Therefore, this terminology is considered to be consistent with the proposal that is being examined and analysed later in the thesis.

The UNDP's country classification system is built on the Human Development Index (HDI). HDI measures three basic dimensions of human development; longevity, access to education and income per capita. The HDI classifications are based on fixed cut-off points that are less than 0.550 for low human development, 0.550 – 0.699 for medium human development, 0.700 – 0.799 for high human development and 0.800 or greater for very high human development.[31]

The HDI differences around the world are large and ranging from the highest values in North America, Europe, Japan and Oceania. The lowest values can be found in central Africa. The average HDI for developing countries according to the Human Development Report from 2020 is 0.689, while the index for the least developing countries is 0.538. This can be compared to the average HDI of 0.900 for OECD member countries. In the section of developing countries, some of the following countries can be found; El Salvador, Namibia and Iraq.[32]

1.5.2 Developing Countries in an International Tax Context

Developing countries are dependent on inbound investment from foreign countries in order to achieve economic growth and development. As

[31] Human Development Report (2020), p. 336.
[32] Human Development Report (2020), p. 343-346; When using the term developing countries, I also refer to the less and least developed countries.

developing countries are net importers of capital, they usually prefer taxation based on the location of income production (source-based taxation). Developed countries prefer taxation based on the residence of the income's owner (residence-based taxation) as they are net exporters of capital. Developed countries are usually the ones providing capital through outbound investment and the international expansion of their domestic enterprises.[33]

Developing countries face two considerable difficulties with the existing rules in the international tax system. Firstly, the restriction the rules impose on the ability of developing countries to tax foreign MNE's within their borders. The premise of the current system is that the host of foreign investment should accept several restrictions on their ability to tax that investment. Secondly, the current international tax rules are too complex to administer effectively for developing countries that have resource-constrained tax administrations.[34] Tax administrations in developing countries often find it difficult to build and maintain capacity across all taxes, nevertheless having the capacity required to understand and implement international taxation rules which are often complex.[35] It is also notable that not all developing countries have the technical expertise to deal with complex subjects involving international tax matters.[36] Besides the fact that the administrative capacity is weaker, tax laws are also much less detailed.[37]

The taxation of the digital economy is posing a challenge for developing countries that are particularly vulnerable because of their weak administrative capacity to administer international tax rules and audit and monitor MNE's activities.[38] The digitalisation of the economy is of particular importance to developing countries where there has been a significant expansion of access

[33] Braun & Zagler (2014) p. 244 f.; Daurer (2014) p. 698; Kobetsky (2011) p. 12 and p. 107.
[34] Hearson (2020) p. 2.
[35] Mullins (2020) p. 15.
[36] Valadao (2019) p. 2.
[37] Hearson (2017) p. 6.
[38] Mullins (2020) p. 1 and p. 15.

to digital services and the attendant possibility of the use of information communication and technology (ICT) in order to exploit the local market.[39]

Developing countries may have the most to gain from the introduction of measures aiming to address the digital economy, as some very large consumer markets are located in their jurisdictions.[40] The loss of tax revenues is also presumably more urgent and real in developing countries as they are net importers of both digital goods and services.[41] Further, the tax base of developing countries is presumably more at risk than that of the developed member countries of the OECD. For example, corporate taxation compromises on average 18.6% of all tax revenues in Africa, compared to 9.3% in the OECD member countries.[42] The digital economy therefore likely raises greater challenges for developing countries as they rely more heavily on corporate income tax.[43]

1.6 Theoretical Framework

The concept of inter-nation equity was developed in the mid-20th century and has become the general principle in tax policy discussions dealing with the distribution of taxes between countries. The foundational contribution to the concept is Peggy and Richard Musgrave's 1972 essay, 'Inter-Nation Equity'. The concept is today widely accepted as a criterion for evaluating international tax systems.[44]

Inter-nation equity has an important role to play as a guiding principle in determining how to properly divide the international tax base among countries.[45] There are disparities in how the concept of inter-nation equity is

[39] UN Handbook 2017 p. 21.
[40] The 15th Session of the Committee of Experts on International Cooperation in Tax Matters, 17-20 October 2017 (hereinafter "The 15th Session Report") p. 34.
[41] UN Handbook 2017 p. 482.
[42] OECD, Corporate Tax Statistics (Paris: OECD, 2020) p. 4; UN Handbook 2017 p. 482; Rukundo (2020) p. 19.
[43] UN Handbook 2017 p. 522.
[44] Brooks (2009) p. 2 and p. 21; Ozai (2020) p. 59.
[45] Ozai (2020) p. 58.

understood in the tax literature and much of the purpose behind its original formulation has been lost over the years. However, it does not seem to be a disagreement about the concept's primacy as a normative directive for how to allocate taxing rights between countries.[46] The approach to inter-nation equity by many (presumably largely legal) scholars is to use inter-nation equity to invoke some sense of the fairness of the tax revenue split between countries, each of whom might have a taxing right to that revenue.[47]

In this thesis, the concept of inter-nation equity will be applied as an evaluative criterion in the analysis of which of the proposals is in favour of developing countries. The thesis will not rely on the original conception of inter-nation equity, but rather on Avi-Yonah's suggestion of giving the concept a "practical meaning" by embracing its redistributive aspect and using it as a decision rule. Avi-Yonah argues that where there are "two otherwise comparable alternative rules, one of which has progressive and the other regressive implications for the division of the international tax base between poorer and richer countries, the progressive rule should be explicitly preferred to the regressive one".[48]

By using Avi-Yonah's suggestion of the concept, the analysis will argue that preference should be given to the interests of developing countries as we choose among competing solutions to an international tax issue, in this case, taxation of the digital economy. I have chosen tax revenue generation and the complexity in administering and implementing the proposals as the two assessment criteria. This is motivated by considering that corporate tax revenues are especially important for developing countries and that they often lack administrative capacity to deal with complex international tax matters.

[46] Ozai (2020) p. 59 and p. 62.
[47] Brooks (2009) p. 18 f.
[48] Avi-Yonah (2000) p. 1650.

1.7 Delimitations

The OECD's Inclusive Framework is considering two different tax reform plans intended to develop global methods for taxing the digitalised economy, Pillar One and Pillar Two. In this thesis, a delimitation has been made by excluding Pillar Two as Pillar One is the tax reform that directly deals with issues regarding jurisdiction and allocation of taxing rights. Pillar One consists of three mechanisms – Amount A, Amount B and tax certainty. The focus will rely on Amount A which is the most controversial part of Pillar One as it presents the most significant structural reform and the new taxing right.

The Pillar One proposal contains over 100-pages for Amount A, and the report with the draft and commentary of Article 12B contains over 70-pages. Therefore, I have not been able to cover all aspects of the proposals. For example, I have not covered carve-outs, tax base determinations, elimination of double taxation and the dispute prevention framework. Besides the implementation of the proposals, I have briefly examined the key aspects in both proposals that are needed to solve the cases and allocate the tax revenue.

As consensus has not yet been reached on a multilateral approach, several countries have integrated domestic digital services taxes in their tax systems. Also, a digital service tax has been proposed by the European Union. These legislations and proposals will not be addressed since the focus of the thesis is to provide an overall analysis of the proposals aiming at reaching a global consensus.

During the time I have written this thesis, the UN has published the final draft of Article 12B.[49] Due to time considerations, the final draft has not been examined.

[49] See the 22nd Session Report; It can be noted that the main features of Article 12B have not changed.

1.8 Outline

Following the introduction, the second chapter sets an overview of the established principles in international taxation and the challenges brought about by digitalisation. Chapter 3 presents the OECD proposal under Pillar One, with a focus on Amount A. The UN's Article 12B will be presented in chapter 4. In chapter 5, the instruments will be compared and analysed in order to determine the similarities and differences. In this chapter, the concept of inter-nation equity will underlie the analysis. Chapter 3, 4 and 5 will follow a similar disposition that is inspired by the disposition of OECD's Pillar One. The reason for this is to provide a uniform examination of the proposals by using a similar structure and facilitate the following analysis. The last chapter will outline a concluding analysis based on the findings in the thesis.

2 The International Tax Regime in a Digital Era

2.1 Introduction

This chapter provides a historical overview of the work of the League of Nations on international taxation and its focus on preventing double taxation. The development of tax treaties will be examined and the fundamental concept of permanent establishment. The purpose of the historical overview is to explain the reason behind the current challenges posed by the digitalisation. Further, the meaning of the term "digital economy" will be explored as well as the key business models of the digital economy. The last part of the chapter will be dedicated to describing current challenges of taxing the digital economy.

2.2 Historical Development

2.2.1 International Double Taxation

The establishment of the League of Nations in 1920 was a significant turning point in the evolution of the international tax regime.[50] Before World War I, the income tax systems of most developed countries were yet not established, and companies restricted operations to their domestic markets which were relatively independent and closed. This changed after World War I due to the expansion of world trade through developments in manufacturing and transport.[51]

International trade resulted in growing cross-border investment and commerce, however, it also resulted in the expanding problem of international double taxation on cross-border income. Double taxation was the result of the

[50] Jogarajan (2018) p. 14.
[51] Kobetsky (2011) p. 11 and p. 111; Hearson (2021) p 38.

competing and overlapping taxing rights of residence and source countries, which led to more than one country taxing the same income. International double taxation was an obstacle for the financial reconstruction of Europe after the war, and the consequences of double taxation were significant at that time because of the high tax rates.[52]

In 1922, the League of Nations appointed a committee of economic experts (Committee of Experts) to study the economic consequences of double taxation and develop theoretical principles for international taxation. The main issue was to solve the problem of international double taxation, which meant developing general principles to determine which state would give up or modify its tax claims on international income. The Committee of Experts were also asked to ascertain whether such principles were applicable for application to a new international convention.[53]

In March 1923, the Committee of Experts submitted a report with their findings to the League of Nations that set out the basic principles underlying international tax jurisdiction for the first time.[54] The report proposed that the right to tax should be divided between residence and source countries. On resolving the problem of double taxation, the report recommended the "method of classification and assignment of sources" as the basis for bilateral tax treaties between countries. Under this approach, different items of income were classified and then assigned to either the residence country or the source country.[55]

The report concluded that an exemption from source taxation, in other words pure residence-based taxation, was the preferred international method. The report proposed an allocation of taxing rights between residence and source

[52] Jogarajan (2018) p. 7; Kobetsky (2011) p. 107 f. and p. 111; Daurer & Krever (2014) p. 4 f.
[53] Jogarajan (2018) p. 19; Kobetsky (2011) p. 112; Elliffe (2020) p. 534.
[54] League of Nations, G. W. J. Bruins et al., Report on Double Taxation: Submitted to the Financial Committee (Geneva: League of Nations, 1923) (hereinafter "The 1923 Report"); Kobetsky (2011) p. 112.
[55] The 1923 Report p. 42; Kobetsky (2011) p. 112.

countries so that some items of income were subject to source taxation while others were not. This meant that some income would be fully subject to residence-based taxation.[56] In the following years, the fundamentals of the current international tax system were established: the primary right of taxation should correspond to the country of residence and the country of source should have a right to tax only as an exception.

2.2.2 Origins of the Model Tax Treaties

The primary purpose of tax treaties is the elimination of international double taxation. The purpose is primarily achieved through the limitation of taxing rights through the application of allocation rules that either grant the taxing right to the residence country or the source country. The allocation rules indicate which of the contracting states has the right to tax and to what extent the taxing right can be exercised.[57]

The report from the Committee of Experts envisioned the creation of a model convention for tax treaties. In 1928, a model convention draft was presented by the League of Nations which later resulted in two major tax treaty models being established. The so-called Mexico Draft in 1943 and the London Draft in 1946.[58] The Mexico and London Drafts were influential on the terms and principles of bilateral tax treaties; however, they were not complete in their coverage or consistent in their approaches.[59] The Mexico Draft gave equal weight to source-based taxation, while the London Draft was criticised for assigning more taxing rights to the residence country and therefore favouring residence-based taxation.[60]

[56] The 1923 Report p. 41 f.; Elliffe (2020) p. 534 f.; Kobetsky (2011) p. 113 f.
[57] Kobetsky (2011) p. 43-46 and p. 107 f.
[58] League of Nations, Double Taxation and Tax Evasion: Report Presented by the General Meeting of Government Experts on Double Taxation and Tax Evasion (Geneva: League of Nations, 1928); Kobetsky (2011) p. 154; M. Graetz & M. O'Hear (1997) p. 1078.
[59] Lennard (2008) p. 23.
[60] League of Nations, Fiscal Committee, London and Mexico Model Tax Conventions: Commentary and Text (Geneva: League of Nations, 1946); Lennard (2008) p. 23. Kobetsky (2011) p. 143 f.; Whittaker (1982) p. 43 f.; Binder & Wöhrer (2019) p. 9.

As of 1954, the efforts begun by the League of Nations were pursued by the Organisation for European Economic Cooperation (OEEC) and its successor, the OECD. In the OECD's constituting document signed in 1960, the main aim and purpose was introduced. This was to promote the growth, employment, and economic expansion of its member countries.[61]

The ultimate result of the work begun by the League of Nations was the *OECD Model Tax Convention on Income and Capital* (OECD Model). In 1963, the OECD released its first model tax treaty, which was based on the London Draft from 1946.[62] Besides the model treaty being massively influenced by the London Draft, it included additional features which benefited developed countries, in other words benefiting the residence-based principle.[63]

The draft from 1963 later resulted in the release of the OECD Model in 1977. As the OECD Model puts most emphasis on residence-based taxation and imposes restrictions on the taxing rights of capital-importing countries, the OECD indicated that the model was for use by member countries when negotiating tax treaties with each other. Despite this, the 1977 OECD Model became the standard for tax treaty negotiations between both member countries and non-member countries.[64]

The rising impact of the OECD Model led to concerns about the risks tax treaties had on the taxing rights of lower-income, capital-importing countries. However, there was also desirability of encouraging negations of tax treaties between developed and developing countries. The reason behind this was to promote the flow of foreign investment to developing countries. Even though

[61] OECD, Convention on the Organisation for Economic Co-operation and Development, Paris, 14 December 1960, at Art. 1; Kobetsky (2011) p. 154; See Christians & van Apeldoorn (2018) p. 231.
[62] Rohatgi (2018) p. 54 f.; Kobetsky (2011) p. 156; Brooks & Krever (2015) p. 164.
[63] Binder & Wöhrer (2019) p. 10.
[64] OECD, Report on Fiscal Initiatives for Private Investment in Developing Countries, 1965, p. 163-165; Brooks & Krever (2015) p. 164; Hearson (2017) p. 10.

the OECD Model was not in favour of source-based taxation, it eliminated double taxation which was a barrier for cross-border trade and investment.[65]

The concerns about the consequences of the divisions of taxing rights based on the OECD model led to action being taken by the UN, which released their first model convention in 1980.[66] The UN Model is generally preferable to the host countries of investment as it is designed to assist developing countries to tax a larger part of the foreign investor's income than the OECD Model. Therefore, it imposes fewer restrictions on the taxing rights of the source country.[67]

When the UN Model was introduced and established, the OECD had already become the market leader in developing tax standards and guidelines. Using modern terms, the UN Model is the successor to the source country-predominant Mexico Draft, while the OECD model is the successor of the London Draft.[68] The main reason for the existence of the two different model treaties is the balance of source-based taxation and residence-based taxation.[69]

Developing countries' tax treaties still bear more resemblance to the OECD Model than the UN Model.[70] Tax treaties are considered the key mechanism that deprive developing countries of tax revenue. This is because they set limits on when, and in some cases at what rate, the contracting countries can tax cross-border economic activity, primarily imposing restriction on the host countries of foreign direct investment, the capital-importing country. Several legal scholars have argued that the effect of tax treaties is regressive redistribution to the benefit of developed countries at the expense of the

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[65] Binder & Wöhrer (2019) p. 10 f.; Brooks & Krever (2015) p. 164; UN, Model Tax Convention Between Developed and Developing Countries 2017 (New York: UN, 2017) (hereinafter "UN Model 2017") p. 5.
[66] Brooks & Krever (2015) p. 164 f.; Berglund & Cejie (2018) p. 35.
[67] Kobetsky (2011) p. 51; Lennard (2008) p. 25.
[68] Lennard (2008) p. 23.
[69] Lennard (2008) p. 25.
[70] Christensen, Hearson & Randriamanalina (2020) p. 8.

developing ones.[71] The residence bias has not been addressed during the BEPS process, however, it remains a relevant issue for many developing countries.[72]

2.2.3 The Concept of Permanent Establishment

In 1928, the League of Nations introduced an article providing for the taxation of business profits made by a PE. The article was the formal recognition that a source country was entitled to tax business profits derived by a non-resident through a PE.[73] However, the article's main features were defined to reduce the level of taxation in the source country.[74] When the concept of PE was introduced, it was presented with emphasis placed on permanence and physical presence and suggested that there should be a threshold before an enterprise had a taxable exposure in a country. Therefore, the existence of a PE depended on physical presence of either personnel or a fixed place of business.[75]

The PE threshold tests which were developed by the League of Nations are today reflected in the OECD Model and the UN Model.[76] Article 7 of the OECD Model and UN Model provides for the general distributive rule on business profits. Under Article 7, a source country has taxing rights over business profits derived by a non-resident enterprise if it has a PE situated in the source country, however, the taxing right is limited to the profits which are attributable to the PE.[77]

Article 7 of the UN Model has features that differ from the OECD Model.

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[71] Brooks & Krever (2015) p. 159 and p. 160; Dagan (2000) p. 4, p. 45 and p. 47; Hearson (2021) p. 4 f.
[72] Lips & Mosquera Valderrama (2020) p. 14.
[73] Rohatgi (2018) p. 58; Kobetsky (2011) p. 122.
[74] UN Handbook 2017 p. 385.
[75] The 15th Session Report p. 16.
[76] Kobetsky (2011) p. 151.
[77] Kobetsky (2011) p. 1 f.; See Article 7 in OECD, Model Tax Convention on Income and on Capital: Condensed Version 2017 (Paris: OECD, 2017) (hereinafter "OECD Model 2017"): Article 7 in UN Model 2017.

The UN Model allows taxation of certain profits not actually attributable under normal rules to the PE, but which relate to income derived from other sales and business activities similar to those performed by the PE. The UN Model therefore provides more taxing rights to the source country as it lowers the threshold and strengthens the position of the country in which the PE is situated. This leads to the allocation being more suitable for the taxing needs of developing countries that rely on source-based taxation.[78]

The term PE is defined in Article 5 of the OECD Model and the UN Model, which addresses the sufficient level of activity required before source taxation may be exercised under a tax treaty. Under Article 5, a PE will exist if one of two tests is met, the general ”fixed place of business” test, or the ”dependent agent” test. Both tests demand a certain level of physical presence in the source country. A PE must also, besides be having a physical presence, be engaged in the core activities of the business.[79] The differences between the definition of PE in the OECD Model and the UN Model involves the range of activities encompassed in the term. The UN Model partly deviates from the OECD Model as it contains a broader definition of the term because it has a larger scope of activities that may constitute a PE.[80]

An important limitation in source-based taxation is that the taxing rights of the country where the PE is situated are restricted to the amount of profits attributable to the PE. The attribution is based on the internationally accepted arm’s length principle which is intended to provide an equitable method for attributing the business profits to the PEs of an international enterprise.[81] The amount of income attributable to a PE is determined by assuming that the PE is a separate legal entity and that it deals at arm’s length with other parts of

[78] Rohatgi (2018) p. 179; Lennard (2009) p. 7.
[79] See Article 5 in the OECD Model 2017 and UN Model 2017; Kobetsky (2011) p. 182 f.; Lennard (2009) p. 4; Rohatgi (2002) p. 60.
[80] See Article 5 in the OECD Model 2017 and UN Model 2017; Rohatgi (2018) p. 180; Binder & Wöhrer (2019) p. 38 f.; See Lennard (2009) p. 4 f. for a discussion about the duration tests before presence is regarded as constituting a PE.
[81] Rohatgi (2018) p. 183; Kobetsky (2011) p. 51; OECD, Tax Challenges Arising from Digitalisation —Interim Report 2018 Final Report: Inclusive Framework on BEPS (Paris: OECD, 2018) (hereinafter “OECD Interim Report 2018”) p. 168.

the enterprise, including the head office, of which the PE is a part. Under the arm's length principle, the transfer prices for transactions between related or associated enterprises must reflect the prices that independent enterprises would have used for similar and comparable transactions.[82]

2.3 Current Tax Challenges Raised by the Digital Economy

2.3.1 Digital Business Models and Their Key Features

The term "digital economy" has no authoritative definition, however, all the attempts to arrive at a definition have in common that the use of ICT is regarded as having a crucial role in defining the digital economy. The term includes all forms of business models that rely predominantly on the use of ICT, and the term can be described as "the global network of economic and social activities that are enabled by platforms such as the Internet, mobile and sensor networks."[83]

The spread of ICT across different sectors has led to the growth of the digital economy in both developed and developing countries. Modern advances in ICT has led to the emergence of new business models used by both large MNEs and start-ups. The most famous example is perhaps e-commerce.[84] Apart from e-commerce, the digital economy has given rise to several innovative business models, products and services, such as online app stores, online advertising, cloud computing, online payment services, high-frequency trading and participative networked platforms.[85]

Through technological advances, it has become possible for enterprises to have significant market penetration in a country while avoiding the

[82] Kobetsky (2011) p. 51 and p. 72; Avi-Yonah (2019) p. 30.
[83] UN Handbook 2017 p. 489 f.; W. Blum (2015) p. 314.
[84] UN Handbook 2017 p. 490; OECD Action 1 p. 52.
[85] UN Handbook 2017 p. 494; OECD Action 1 p. 54.

establishment of a taxable presence through a PE.[86] The current thresholds for taxation rely on physical presence because of the need in many traditional businesses for a local physical presence in order to conduct substantial sales of goods and services into a market jurisdiction. The question that therefore arises is whether the existing rules under tax treaties allocating taxing rights among countries based on the PE criteria are any longer appropriate regarding the new business models based on digital technologies.[87]

The degree of presence does not only determine the existence of a taxable presence in form of a PE, but it also indirectly determines how much profit can be attributed to it. The heavy reliance of MNEs on intangible assets and the importance of data and user participation as a primary source of value has besides challenged the notion of PE, also challenged the application of the arm's length principle as a basis for allocating the profits of international enterprises. In the area of direct taxation, the main challenges raised by the digitalisation for corporate income tax can be divided into three different categories; nexus, data and characterisation. These challenges go beyond tax avoidance and tax evasion and relate to the question of how taxing rights on income generated from cross-border activities in the digital environment should be allocated among countries.[88]

2.3.2 Nexus

Nexus can broadly be described as the connection between an activity and a country sufficient to allow, at domestic law and under a treaty (where applicable) to tax the returns from such an activity. The question of nexus relates in particular to the definition of PE for treaty purposes and the related attribution rules under the arm's length principle. As described in section 2.2.3., the current jurisdictional nexus under bilateral tax treaties is that of a PE, which requires a level of permanency in the activity.[89] The PE concept is

[86] UN Handbook 2017 p. 20 f.; W. Blum (2015) p. 314 f.
[87] OECD Action 1 p. 98 f.; See section 2.2.3.
[88] OECD Action 1 p. 98 ff. and p. 146; Kobetsky (2011) p. 75-78.
[89] OECD Action 1 p. 100 f.; UN Handbook 2017 p. 501; The 15th Session Report p. 18.

no longer effective in a modern age where technology allows buyers and sellers to conduct cross-border business without ever establishing a physical presence in a non-resident country.[90]

2.3.3 Data

It is common for digital businesses to collect data about their users, customers, suppliers and operations. Data can broadly be described as the information that is collected digitally and which creates value to MNEs. The gathering and use of information across borders raise the issue of how to determine and attribute value created from the generation of data through digital products and services. The increasing role of data raises questions about whether current nexus rules continue to be appropriate or whether any profits attributable to the remote gathering of data by an enterprise should be taxable in the country from which the data is gathered. It also raises questions about whether data is being appropriately characterised and valued for tax purposes. The heavy reliance of MNEs on intangibles together with the increasing significance of data in the global value chains put additional pressure on the rules of profit allocation to PEs.[91]

2.3.4 Characterisation

Characterisation can broadly be described as the treatment of different activities in the digital economy that affects the tax charges of MNEs. The development of new digital products or means of delivering services raises uncertainties in relation to the proper characterisation of payments that are made in the context of new business models. Under most tax treaties, business profits would be taxable in a country only if it is attributable to a PE located there. Whether a certain transaction is characterised as business profits or as another type of income can result in different outcomes in tax treaties.[92]

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[90] Hoffart (2007) p. 107.
[91] OECD Action 1 p. 99 and p. 102-104; UN Handbook 2017 p. 504-506.
[92] OECD Action 1 p. 99, p. 104 and p. 106; The 15th Session Report p. 18 and p. 20; UN Handbook 2017 p. 506 f.

Currently, business profits earned by non-resident companies from online sales or supply of services or intangibles are not taxable in the market jurisdiction because of the lack of a PE or lack of profit attributable to the PE. The result of this is that countries are deprived of tax revenues from the traditional sale of goods that countries would have been entitled to tax under the existing rules regarding jurisdiction to tax.[93] The digital economy requires new nexus rules or new ways of implementing existing principles in order to ensure a fair sharing of the tax base among countries, especially between developed and developing ones.[94]

2.4 Concluding Remarks

With this chapter, the historical structures and conceptual foundations of the current international tax regime were emphasised. It is important to describe the bias towards residence taxation and the difficulties that developing countries face by the structures that still exist in the international tax system. This is the reason behind the existence of the two different model conventions from the OECD and the UN. Even though the model conventions are similar in structure and features, the UN Model provides more tools for source-based taxation and therefore preserves the taxing rights of developing countries. This brief historical overview of the international tax regime, and the balance between taxing rights, provides an understanding of why two different solutions to the taxing of the digital economy are proposed. These proposals will be addressed in the following chapters.

[93] UN Handbook 2017 p. 20 f.
[94] UN Handbook 2015 p. 412.

3 The OECD's Report on Pillar One

3.1 Introduction

This chapter provides an examination of the OECD's Pillar One. The earlier initiatives taken by the OECD will be examined, as well as the background to the current proposal. The chapter will explore and describe the new taxing right of the proposal - Amount A. This examination lays the ground for the last part of the chapter where the proposal is applied to the two cases. The demonstration of the outcome of Pillar One, and more specifically Amount A, will be an essential part of the later analysis of the proposal.

3.2 Background

The release of the Action 1 Report in 2015 identified the tax challenges of the digital economy as one of the main areas of focus for the G20/OECD BEPS project.[95] In 2016, the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework) was established. The Inclusive Framework goes beyond the OECD and G20 countries and currently consists of 137 countries and jurisdictions.[96] The participation in the Inclusive Framework has been conditioned by implementing four minimum standards in the BEPS project, which was developed without developing countries' participation.[97] The Inclusive Framework is therefore built on membership being premised on non-OECD countries that had no say in the first BEPS process in 2013-2015

[95] OECD Action 1.
[96] Pillar One p. 3 and p. 10; It is important to note that many parts of the developing world have not yet joined. For example, almost half of Africa has not joined the Inclusive Framework. These countries include Algeria, Ghana and Zimbabwe. See Ovonji-Odida, Grondona & Makwe, "Assessment of the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalization of the Economy", the South Centre, August 2020, p. 11.
[97] Hearson, Ndubai & Randriamanalina (2020) p. 26.

but are forced to accept and implement the BEPS outcomes.[98] The implementation of the minimum standards have raised concerns about fairness as developing countries are required to introduce changes into their domestic law and tax treaties, but some important issues of concern for these developing countries such as allocation of taxing right between residence and source are not dealt with in the BEPS Project.[99] Many countries have joined the Inclusive Framework for help aligning domestic rules with international standard, or because of coercive pressure, and therefore not primarily to participate in standard-setting.[100] The implementation of the BEPS project in developing countries has also led to different issues, which includes increased complexity in tax legislation and the diversion of resources from other challenges, such as preventing corruption and improving tax collection.[101]

As a follow-up to the Action 1 Report from 2015, the Inclusive Framework released an Interim Report in 2018. The Interim Report recognised the need for a global solution on the taxation of the digital economy.[102] Later in January 2019, a policy note was published that suggested a two-pillar approach. This was a revolutionary document as it began from the premise that addressing the tax challenges of the digital economy meant to re-examine the jurisdictional taxing rights. Such an exercise had never been carried out since the international taxation rules were first formulated in the 1920s by the League of Nations.[103]

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[98] Cobham, "A Pyrrhic victory for the OECD?", Tax Justice Network, Blog, 31 January 2020.
[99] Burgers & Mosquera Valderrama (2017) p. 40.
[100] Christensen, Hearson & Randriamanalina (2020) p. 29.
[101] World Economic Forum, "Corporate Tax, Digitalization and Globalisation", December 2019, p. 15.
[102] OECD Interim Report 2018; Pillar One p. 10.
[103] OECD, Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note, 23 January 2019; Ovonji-Odida, Grondona & Makwe, "Assessment of the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalization of the Economy", the South Centre, August 2020, p. 9.

In 2019, the Inclusive Framework introduced a proposal designed for a global consensus, the Unified Approach under Pillar One and Pillar Two.[104] In October 2020, a revised version of the proposals was published, the Report on Pillar One Blueprint and the Report on Pillar Two Blueprint.[105] The aim of Pillar One is to adapt the international income tax system to new digital business models through the amendment of profit allocation and nexus rules applicable to business profits. More precisely, it seeks to expand the taxing rights of market/user jurisdictions where there is an "active and sustained participation of a business in the economy of that jurisdiction through activities in, or remotely directed, at that jurisdiction".[106] The term market jurisdiction concerns jurisdictions in which significant numbers of digital service users, customers or consumers are located.[107]

Pillar One reflects extensively technical work that has been done to achieve a sustainable taxation framework that reflects the increasingly digitalised economy, with the possibility to achieve a more fair and efficient allocation of taxing rights. It is important to consider that an agreement has not yet been reached and that further significant work will be required in order to reach any consensus on many of the fundamental potential principles that are covered. The stated aim is to reach a successful conclusion by mid-2021.[108]

3.3 The OECD's Proposal

3.3.1 Scope

The new taxing right introduced through Amount A only applies to MNE groups that fall within the defined scope of Amount A. The scope aims at

[104] 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 – January 2020.
[105] OECD, Cover Statement by the Inclusive Framework on the Reports on the Blueprints of Pillar One and Pillar Two, p. 3; Pillar One p. 7 f.
[106] Pillar One p. 11.
[107] OECD, Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy, May 2019, p. 11.
[108] Pillar One p. 8 f.

MNEs that perform in-scope activities as defined in Pillar One, combined with a double revenue threshold that takes into account consolidated group revenues and the MNE's revenue earned outside its domestic market. The scope of Amount A is therefore based on two different elements, an activity test and a threshold test.[109]

3.3.1.1 Activity Test

The definition of the in-scope activities that are found in Pillar One, and would be included in the scope of the new taxing right, is automated digital services (ADS) and consumer-facing business (CFB). These two groups of digital business models reflect the types of activities where the policy challenge is most urgent. Great technical work has been done on how ADS and CFB could be defined, however, there is yet no political agreement reached on the use of the categories.[110]

Currently, the definition of ADS is built on a positive list of ADS activities[111], a negative list of non-ADS activities[112] and a general definition. The general definition is currently defined as services made available to users (both institutional and private individuals) through digital means (over the Internet or an electronic network), which is achieved in an automated matter (requiring minimal human involvement) by equipment and systems in place for this purpose.[113]

CFB is defined in Pillar One as businesses that generate revenue from the sale of goods and services of a type commonly sold to consumers, including those selling indirectly through intermediaries and by way of franchising or

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[109] Pillar One p. 19.
[110] Pillar One p. 22.
[111] This list currently includes online advertising services; sale or other alienation of user data; online search engines; social media platforms; online intermediation platforms; digital content services; online gaming; standardised online teaching services; and cloud computing services.
[112] The list currently includes customised professional services; customised online teaching services; online sale of goods and services other than ADS; revenue from the sale of a physical good irrespective of network connectivity ("Internet of things"); and services providing access to the Internet or another electronic network.
[113] Pillar One p. 22 f.

licensing. The definition of CFB includes traditional non-digital businesses that have embraced digitalisation, which allows them to participate in an active and maintained matter in the economic life of an external market through the use of consumer-facing intangibles, without a corresponding share assigned to the market jurisdiction.[114]

3.3.1.2 Threshold Test

The second element of defining the scope of Amount A is the threshold test. The purpose of the thresholds is to minimise the compliance costs for MNEs and facilitate the administration of the new rules for tax administrations. The first threshold test is a global revenue test which would limit the scope of Amount A to large MNEs with consolidated annual revenue exceeding a defined threshold, which currently would not be less than EUR 750 million.[115]

The threshold would be accompanied by a second threshold, a de minimis foreign in-scope revenue threshold, which relates to MNEs that exceed the first mentioned gross revenue threshold but have a small amount of foreign source in-scope revenue. The threshold therefore aims to exclude MNEs that generate only a small portion of their revenues from foreign market jurisdictions. Pillar One proposes that this threshold should be applied on an absolute number rather than relative to the size of the domestic business of the MNE. The Pillar One uses a threshold of EUR 250 million in an example that illustrates the de minimis foreign in-scope revenue test. If an MNE would not meet the de minimis foreign in-scope revenue threshold, it would not be included within the scope of Amount A.[116]

The scope of Amount A remains one of the key pending political issues to be solved. There is yet no political agreement reached on the use of the categories ADS and CFB and the Pillar One also indicates that further work

[114] Pillar One p. 37.
[115] Pillar One p. 58.
[116] Pillar One p. 59 f.

would be performed to agree on the definitive thresholds. Therefore, the scope of Amount A remains to be settled upon.[117]

3.3.2 Nexus Rules

The nexus rules found in Pillar One identifies and determines market jurisdictions that are eligible to receive Amount A. The nexus rules are based on a series of indicators of significant and sustained engagement of an MNE in a specific jurisdiction. Without the engagement with a jurisdiction, none of the MNE's profits would be reallocated to that jurisdiction under Amount A. The indicators may differ depending on whether the activity is ADS or CFB, as the Pillar One could set different nexus rules for ADS and CFB. In the following, the examination will focus on ADS.[118]

Pillar One proposes a certain market revenue threshold as the only test to establish nexus for ADS. This is because the very nature of ADS allows them to be provided remotely and that this type of businesses generally have a significant and sustained engagement with the market jurisdiction even if there is no physical presence. The threshold proposed would apply to the in-scope revenue of a group generated in a market jurisdiction. The nexus would therefore be established by exceeding a market revenue threshold of EUR X million per year. Pillar One notes that the threshold is expected to be set below EUR 5 million.[119]

Pillar One states that a temporal requirement, for example a duration test, might be designed to avoid covering one-off transactions which would not be representative of a sustained engagement with a market jurisdiction. Further, depending on where the threshold amount is set, Pillar One considers using a lower nexus standard for smaller developing economies with GDP below a certain level while also considering compliance simplification. On the

[117] Pillar One p. 19 and p. 11 f.
[118] Pillar One p. 64.
[119] Pillar One p. 65 f.

contrary, consideration is being given to using higher thresholds for large markets.[120]

3.3.3 Revenue Sourcing Rules

The nexus rules are supported by detailed revenue sourcing rules that are aimed at determining the revenue that should be treated as derived from a particular market jurisdiction. In order to source the relevant in-scope revenue to a market jurisdiction, the Pillar One proposal identifies a sourcing principle for each type of in-scope revenue, accompanied by a hierarchical list of acceptable specified indicators which an MNE will use to apply the principle and identify the jurisdiction of source. In addition, the MNE will then have to follow specific rules on documentation requirements.[121]

Pillar One contains draft rules on revenue sourcing that the MNE must apply to each type of revenues that it generates. The MNE has to apply the indicator which appears first in the hierarchy as it will be the most accurate indicator. However, if an indicator is unavailable or unreliable, the MNE should seek to apply the second indicator in the hierarchy.[122]

For ADS, Pillar One has set out a non-exhaustive indicative list of the type of revenues that ADS businesses usually earn, and the revenue sourcing rules they would have to apply for each separately identified revenue stream. In the sourcing rules, each type of activity has its own set of sourcing rules, supported by a range of indicators. Therefore, Pillar One sets out the sourcing rule and relevant indicator per type of revenue. The list includes indicators for revenue sourcing such as geolocation data, Internet Protocol (IP) address, virtual private network (VPN), user profile information, billing address and other available information.[123] Pillar One further explains the relevant business models and the rationale for the sourcing rule, together with

[120] Pillar One p. 65.
[121] Pillar One p. 70.
[122] Pillar One p. 71.
[123] Pillar One p. 72-79.

guidance on applying the indicators.[124] The section of revenue sourcing rules in Pillar One will be subject to further discussion and refinement.[125]

3.3.4 Profit Allocation

The profit allocation in Pillar One presents the formula to determine the quantum of Amount A. A new formulary allocation method will be applicable to allocate a portion of an MNE group's residual (non-routine) profits[126] arising from in-scope activities in each market country in which a nexus has been established. The calculation and allocation of Amount A will be delivered by using a formula that is not based on the arm's length principle. The formula would apply to the tax base of a group and involve three important components. The components are represented in the following:

Step 1 would be to define a profitability threshold in order to isolate the residual profits subject to reallocation. Step 2 would be to define a percentage of the residual profit as the allocable tax base which is subject to reallocation to the market jurisdictions. Step 3 would be to use an allocation key to distribute the allocable tax base among the eligible market jurisdictions, which is jurisdictions with nexus established for Amount A. This three-step formula could be implemented through either a profit-based approach or a profit margin-based approach. Both approaches would apply the three-step formula similar and should deliver the same quantum of Amount A taxable in each market jurisdiction.[127] It is important to consider that Pillar One does not specifically define the profitability threshold or the reallocation percentage, meaning that there is no consensus yet on step 1 and 2.[128]

[124] For example, revenue from online advertising services, revenue from the sale or other alienation of user data, intermediation of tangible and intangible goods and services and revenue from digital content services.
[125] Pillar One p. 95 f.
[126] The profits are separeted into residual profits and routine profits in order to remove routine profits from allocation to market jurisdictions.
[127] Pillar One p. 120.
[128] Pillar One p. 133.

3.3.5 Implementation

Implementation of the new taxing right under Amount A would require changes in domestic law and a new multilateral convention would be developed.[129] In order for Amount A to be effectively taxed in each country, countries would have to implement the rules ultimately agreed by the Inclusive Framework into their domestic law. For example, countries will need to create existing taxing rights consistent with the design and implementation of Amount A. However, it is important to consider that domestic implementation is not sufficient as existing bilateral tax treaties contain provisions that would generally prevent the imposition of a tax on Amount A. In addition, tax treaties are unlikely to contain rules on relief of double taxation that would work for Amount A. Tax treaties do also not include rules governing the administration of Amount A.[130]

A new multilateral convention is considered to ensure consistency and certainty in the application and operation of Amount A. The convention would remove the existing barriers in tax treaties while offering the best and most efficient way of implementing Pillar One. As bilateral tax treaties between countries would continue to be in force and govern cross-border transactions outside Amount A, the new multilateral convention would therefore coexist and function with the current tax treaty network. The new multilateral convention would not be applicable to cross-border transactions that are not in the scope of Amount A. The convention would prevail over existing tax treaties in cases of conflict, therefore, there would be no need to amend existing tax treaties. The new multilateral convention would also apply when countries have not concluded a bilateral tax treaty.[131]

Pillar One states that it is expected that any consensus-based agreement includes a commitment by the members of the Inclusive Framework to implement the agreement and at the same time withdraw relevant unilateral

[129] Pillar One p. 14.
[130] Pillar One p. 199 and p. 201.
[131] Pillar One p. 201 f.

actions, and not adopt unilateral actions in the future.[132] The implementation of Amount A will require further work on the multilateral convention. This includes work on the architecture of the convention and its legal functioning. The changes to domestic law and the development of a multilateral convention would be supplemented by both guidance and other instruments where necessary.[133]

3.4 Application of Amount A

3.4.1 Advertisement on Social Media Platforms

The application of Pillar One on the first case would be the following.[134] The first step would be to determine whether the non-resident MNE in country A falls into the scope of the new taxing right. The MNE provides advertisements on social media, which according to the activity test in Amount A constitutes an ADS. The next step would be determining if the non-resident MNE meets the threshold test, meaning that the non-resident MNE in the case must exceed the consolidated annual revenue threshold of EUR 750 million. The second threshold test is to determine the foreign in-scope revenue threshold, which currently is proposed to be EUR 250 million.

If the non-resident MNE in country A falls into the scope of Amount A, the next step would be to determine the nexus rules which identifies and determines market jurisdictions that are eligible to receive Amount A. The Pillar One only proposes a certain market revenue threshold as the only test to establish nexus for ADS. As there is no number yet, it is assumed in this case that the non-resident MNE exceeds the market revenue threshold in both country B and C.

[132] Pillar One p. 199 and p. 204.
[133] Pillar One p. 204.
[134] See section 1.2.

The next step is applying the revenue sourcing rules that are aimed at determining the revenue that should be treated as derived from a particular market jurisdiction. In this case, the revenue comes from online advertising services. Pillar One states that the sourcing rule is the jurisdiction of the real-time location of the viewer of the advertisement. Further, the first relevant indicator is the jurisdiction of the geolocation of the device of the viewer at the time of display.[135] In this case, it is assumed that this indicator is available and reliable, meaning that the first indicator will be used. Therefore, the revenue from the online advertisements would be sourced to country C where the user is located. Further, the applicable portion of residual profits (the Amount A) is to be allocated to the eligible market jurisdiction which in this case is country C. As the exact numbers are not relevant for the outcome of the case, the important outcome is that Amount A is sourced to country C, which means that the new taxing right is established for country C.

3.4.2 Collection of Data Based on Real-time Location of Users

The application on Pillar One on the second case would be the following.[136] The first step would be to determine whether the non-resident MNE in country A falls into the scope. The MNE collects user data that it sells to a third party, which according to the activity test in Amount A constitutes an ADS. In this case, it is assumed that the non-resident MNE meets the global revenue test of EUR 750 million and the second de minimis foreign revenue threshold of EUR 250 million.

The non-resident MNE exceeds the market revenue threshold and a nexus is created in both country B and C, which means that both are eligible to receive Amount A. According to the revenue sourcing rules, the sourcing rule is the jurisdiction of the real-time location of the user that is the subject of the data being transmitted, at the time the data was collected. The relevant indicator is

[135] See Pillar One p. 72.
[136] See section 1.2.

the jurisdiction of the geolocation of the device of the user at the time of collection.[137] In this case, the jurisdiction would be country B. Therefore, the revenue from user data would be sourced to country B where the users are located.

3.5 Concluding Remarks

A significant part of the OECD's proposal under Pillar One is still preliminary and under review. Therefore, it is possible that the outcome will be different from the one described above. However, it is significant that the proposal leads to an allocation to a market jurisdiction which is not possible under the current rules. Under the current rules, the company resident in country A (in both cases) can operate without creating a taxable presence. This would lead to the revenue being sourced to the residence country, country A, which would be given the exclusive taxing right. The implementation of Pillar One would lead to a historical change to the current international taxation rules as it would reallocate a share of the residual profit of the MNE to country C and country B, which would be given the new established taxing right under Amount A.

[137] See Pillar One p. 73 f.

4 Article 12B of the UN Model

4.1 Introduction

This chapter examines the draft of the new Article 12B. The earlier initiatives taken by the UN will be examined, as well as the background to the proposed Article 12B. The chapter will first describe the proposed draft, and thereafter the commentaries made to it. This examination lays the ground for the last part of the chapter where Article 12B is applied to the two cases. The demonstration of the outcome will be an essential part of the later analysis of Article 12B.

4.2 Background

The UN Tax Committee early recognised the important issues relating to the taxation of the digital economy, and as a consequence agreed on a "Fees for Technical Services" in Article 12A for the 2017 update of the UN Model, which allows developing countries to obtain jurisdiction over some revenues stemming from the digitalised economy.[138] In a report from 2017, the UN Tax Committee stated that the Committee would not wait until the OECD/G20 BEPS report was finalised, as it would be too late and valuable resources and opportunities to respond would be wasted in between those years. The UN Tax Committee decided that it would work independently and craft its own solutions on the tax challenges of the digitalised economy while taking notes of work done in other forums. The same year, the UN Tax Committee formed the UN Subcommittee.[139]

In August 2020, the UN Subcommittee presented a proposal for a new Article 12B ("Income from Automated Digital Services") to be included in the UN Model along with a commentary. The proposal was a result of the UN

[138] The 15th Session Report p. 22.
[139] The 15th Session Report p. 34.

Subcommittee identifying income from ADS as a matter of priority to be dealt with to address the tax challenges of the digital economy. The revised draft of Article 12B of the UN Model was published in October 2020 and directly deals with the issues being addressed separately by the OECD in Pillar One.[140] The final draft was adopted in April 2021 and will be incorporated in the 2021 UN Model.[141]

Article 12B grants additional taxing rights to countries where an ADS provider's customers are located. When the UN identified income of ADS as a matter of priority to be dealt with, the UN decided to focus on a tax treaty provision under the UN Model that would enable jurisdictions to apply their domestic legislation collecting taxes on income derived from digital business models.[142]

4.3 The UN's Proposal

4.3.1 Scope

The scope of Article 12B is limited to income from ADS. In paragraph 4 of the Article, the definition of the term "income from ADS" is payments for any service provided on the internet or an electronic network that requires minimal human involvement from the service provider. The definition in the paragraph is exhaustive which means that other payments for services are not included in the definition and are not dealt with in Article 12B.[143]

A service is considered as automated when the user can make use of the service because of equipment and systems being in a place that allows the user to obtain the service automatically, in opposite to requiring interaction with the supplier to provide the service. The tests to determine human involvement does only look at the supplier of the service, without regard to

[140] The 20th Session Report p. 11.
[141] The 22nd Session Report.
[142] The 20th Session Report p. 11.
[143] The 20th Session Report p. 18 and p. 12.

any human involvement on the side of the user. An important indicator of the term automated is whether there is the ability to scale up and provide the same type of service to new users with only minimal human involvement.[144] Article 12B considers the following services to be ADS: online advertising services; sale or other alienation of user data; online search engines; online intermediation platform services; social media platforms; digital content services; online gaming; cloud computing services and standardized online teaching services.[145]

Paragraph 4 of Article 12B also states that the income from ADS does not include payments qualifying as "royalties" or "fees for technical services" under Article 12 or Article 12A. Therefore, payments qualifying as royalties or fees for technical services are excluded from ADS. Further, Article 12B does not include the following services and activities to be ADS: customized professional services; customized online teaching services; services providing access to the Internet or to an electronic network; online sale of goods and services other than automated digital services and revenue from the sale of a physical good, irrespective of network connectivity.[146] Article 12B does not provide any revenue thresholds in order for the scope to be covered.

4.3.2 Nexus

Article 12B does not require any threshold such as a PE, fixed base or minimum period of presence in a state as a condition for the taxation of income from ADS. As modern methods for delivery of services allow non-residents to perform substantial services for customers in another country with little or no presence, this ability justifies source taxation of income from ADS even in scenarios where there is little or no physical presence in the source jurisdiction.[147]

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[144] The 20th Session Report p. 18.
[145] The 20th Session Report p. 19.
[146] The 20th Session Report p. 12 and p. 22.
[147] The 20th Session Report p. 11 f.

4.3.3 Revenue Sourcing Rules

Paragraph 6 of Article 12B allocates the taxing rights according to the location of the payer for the services. Paragraph 6 states that "income from automated digital services shall be deemed to arise in a Contracting State if the payer is a resident of that State or if the person paying the income, whether that person is a resident of a Contracting State or not, has in a Contracting State a PE or a fixed base in connection with which the obligation to make the payment was incurred, and such payments are borne by the PE or fixed base".[148]

This means that the income from ADS will be sourced to the payer's residence country or to a PE or fixed base. Therefore, the sourcing rule is based on payments rather than user location, which is motivated by administrative difficulties. If there exists an obvious economic link between ADS being provided and the PE or fixed base of the payer to which the services are provided, the income from ADS is considered to arise in the State in which the PE or fixed base is situated. In situations where there is no economic link between the ADS and the PE or the fixed base, the payments for ADS are considered to arise in the Contracting State where the payer is resident.[149]

4.3.4 Profit Allocation

Article 12B requires an MNE group to pay taxes on payments for ADS under one of two approaches. Either taxation on a gross basis according to paragraph 2, or on a net basis according to paragraph 3. Both paragraphs put emphasis on the term "beneficial owner" of the income from ADS rather than the entity which is receiving the payment. The reason for this is to avoid conduit companies and tax havens that are used for tax avoidance purposes. An

[148] The 20th Session Report p. 26.
[149] The 20th Session Report p. 26 and p. 31.

important aspect of the concept of beneficial owner is their ability to use and enjoy the income.[150]

4.3.4.1 Taxation on Gross Basis

Paragraph 2 provides the beneficial owner of income from ADS a withholding mechanism. According to paragraph 2, the Contracting State in which income from ADS arises may tax those payments in accordance with the provisions of its domestic law. However, in a situation where the beneficial owner of the income is a resident of the other Contracting State, the amount of tax imposed by the State in which the income from ADS arises may not exceed a maximum of percent of the gross amount of the payments.

The commentary of Article 12B states that the maximum rate of tax on income from ADS is to be concluded through bilateral negotiations of the Contracting States. Even though the withholding tax rate is to be bilaterally negotiated, the commentary recommends having a modest rate of 3% or 4%.[151] Therefore, the tax would be levied by the source country on the gross revenue at a percentage that would need to be established during bilateral treaty negotiations.

The commentary of Article 12B states that many developing countries have limited administrative capacity and need a simple, reliable and efficient method to enforce tax imposed on income from services derived by non-residents. Further, the commentary states that "a withholding tax imposed on the gross amount of payments made by residents of a country, or non-residents with a PE or fixed base in the country, is well established as an effective method of collecting tax imposed on non-residents".[152]

[150] The 20th Session Report p. 14.
[151] The 20th Session Report p. 13.
[152] The 20th Session Report p. 11.

4.3.4.2 Taxation on Net Basis

Paragraph 3 provides the beneficial owner of the income from ADS the option to be taxed on a net basis annual taxation, instead of the withholding mechanism provided under paragraph 2. According to the paragraph, the beneficial owner of the income from ADS may request the Contracting State where the income arises to be subject to taxation on its qualified profits instead.[153]

Paragraph 3 defines the qualified profits as 30% of the amount arrived at by applying the overall profitability of the beneficial owner or the profitability of its ADS segment, if the same is available, to the gross annual revenue derived from such services in the Contracting State where such income arises. However, if the beneficial owner belongs to a multinational group, the profitability ratio to be applied shall be that of such group, or of its ADS segment, if available.[154]

4.3.5 Implementation

The new Article 12B will be incorporated into the existing UN Model. Therefore, bilateral negotiations are required in order for countries to incorporate Article 12B in their tax treaties. However, it also requires changes in domestic law as a tax treaty does not create a taxing right for a country. A country therefore will need to establish the taxing right with regard to income derived from ADS in its domestic law.[155]

[153] The 20th Session Report p. 16.
[154] The 20th Session Report p. 17.
[155] The 20th Session Report p. 13 and p. 32.

4.4 Application of Article 12B

4.4.1 Advertisement on Social Media Platforms

The application of Article 12B on the first case would be the following.[156] The first step would be to determine whether the non-resident MNE in country A falls into the scope. The MNE provides advertisements on social media, which according to the examples in the commentary to Article 12B constitutes an ADS. Therefore, it falls into the scope of the Article. The next step would be to establish the nexus, and according to Article 12B, there is no threshold required as a condition for the taxation of income from ADS.

The next step is applying the revenue sourcing rules that are aimed at determining the revenue that should be treated as derived from a particular market jurisdiction. According to paragraph 6 of Article 12B, the income would be sourced to the payer's residence country, which is country B. Further, the amount would be determined by the profit allocation rules in either paragraph 2, taxation on a gross basis, or paragraph 3, taxation on a net income basis. Conclusively, the income from the online advertising would be sourced to country B, which would be given the taxing right.

4.4.2 Collection of Data Based on Real-time Location of Users

The application of Article 12B on the second case would be the following.[157] The first step would be to determine whether the non-resident MNE in country A falls into the scope. The MNE collects user data that it sells to a third party, which according to the commentary of Article 12B constitutes an ADS. The next step would be to establish the nexus, and according to Article 12B, there is no threshold required as a condition for the taxation of income from ADS. The next step is applying the revenue sourcing rules that are aimed

[156] See section 1.2.
[157] See section 1.2.

at determining the revenue that should be treated as derived from a particular market jurisdiction. According to paragraph 6 of Article 12B, the income would be sourced to the payer's residence country, which is country C. Further, the amount would be determined by the profit allocation rules in either paragraph 2, taxation on a gross basis, or paragraph 3, taxation on a net income basis. Conclusively, the income from the sale of user data would be sourced to country C, which would be given the taxing right.

4.5 Concluding Remarks

The new Article 12B of the UN Model also leads to an allocation to a market jurisdiction which is not possible under the current rules. Under the current rules in the UN Model, the revenue in both cases would be sourced to the residence country, country A, which would be given the exclusive taxing right. This would change with the incorporation of Article 12B.

5 Comparative Analysis of Pillar One and Article 12B

5.1 Introduction

This chapter provides a comparative analysis of Pillar One and Article 12B. The proposals will be analysed by following the same disposition as the chapters presenting the proposals. The examination will focus on similarities and differences. The analysis will highlight important features of the proposals for developing countries, and the concept of inter-nation equity will be applied throughout the analysis.

5.2 Scope

Both Pillar One and Article 12B cover the taxation of ADS, which is an important common feature in the proposals. Regarding activities constituting ADS, both proposals contain lists of which activities constitute ADS, and which activities does not constitute ADS. If a service does not fall into the lists of either of the proposals, a service can fall into the general definition of ADS in Pillar One and Article 12B. The general definition of ADS in both the Pillar One and the UN proposal is based on the elements of automated and digital.[158]

It is clear that the list of activities constituting ADS in Article 12B is inspired by Pillar One. This is also something that has been brought up by members of the Committee.[159] As this is something that yet is not agreed upon in Pillar One, I question how the outcome will be if Pillar One would be changed in this aspect. For example, if another activity would be added to the positive list or the negative list. This could make enterprises question the possible differences. Another aspect is the fact that new digital business models

[158] See section 3.3.1.1 and 4.3.1.

[159] The 20th Session Report p. 34.

certainly will arise in the near future. I believe that both the negative and positive list will require changes to the ongoing digital environment. As has been described, digital business models evolve constantly and new ones are established. Even though both lists are helpful and can provide some type of certainty to enterprises, they can also be the target of interpretations and lead to disputes.

An important distinction is that Pillar One also covers CFB, which are businesses that sell goods and services that are primarily intended for consumers.[160] In my opinion, the broad definition of CFB will cover a significant part of all large MNEs that may be subject to the new taxing right. That the definition of CFB is quite broad, introduces a number of questions and uncertainties. Therefore, I believe that the definition does not provide the simplicity that is needed for tax administrations, or the certainty that enterprises seek. However, the fact that the definition of CFB is broad and covers less highly digitalised businesses means that the scope will cover a lot more enterprises than when limiting the scope to only ADS. The fact that Pillar One covers CFB, and therefore more enterprises, is in the interest of developing countries as more revenue can be reallocated. Article 12B is different in this aspect by only covering ADS.

Chand and Vilaseca argue that the scope of the UN solution is less neutral and ring-fences the digital economy by only including ADS. Further, they consider Article 12B to be non-flexible due to its narrow scope.[161] The ring-fencing of the digital economy given its scope confined to ADS is a view shared by the IMF, that generally prefers more principled and broader-based reforms.[162] In this part, I agree with Article 12B ring-fencing highly digitalised businesses by only covering ADS. In my opinion, this can create an unfair playing field between enterprises that are in the scope of Article 12B

[160] See section 3.3.1.1.
[161] Chand & Vilaseca, ”The UN Proposal on Automated Digital Services: Is It in the Interest of Developing Countries?”, Kluwer International Tax Blog, Wolters Kluwer, 5 March 2021.
[162] IMF Staff Comments on Proposed UN Article 12B of the UN Model Tax Convention (Automated Digital Services) p. 2.

and enterprises that use ICT in their business models but do not fulfil the general definition of ADS or fall into the positive list. I believe this targeting to be disproportionate between enterprises, as there also is no threshold, which means that any enterprise that falls into ADS will be in the scope of Article 12B. Therefore, the general definition of ADS will be the target of different interpretations and possible disputes. This makes me question whether the current scope of Article 12B is a suitable future solution given the growing and changing digital environment.

The scope of Pillar One is also subject to two thresholds, a global revenue threshold and a de minimis foreign in-scope revenue threshold. In my opinion, these thresholds are too high and significantly limit the MNEs in scope for application of Pillar One. The global revenue threshold is currently set at EUR 750 million, which means that only the world's largest digital enterprises would be affected. Therefore, small and medium-sized enterprises would not fall into the scope of the proposal. In my opinion, there are certainly MNEs operating in developing countries with less global revenue than EUR 750 million. For example, perhaps Africa's best known e-commerce firm, the e-commerce platform Jumia, generated EUR 139.6 million in revenues in 2020.[163]

According to Pillar One, the estimated number of MNEs after applying the activity test and the global revenue threshold is around 2 300.[164] The result of this is that the clear majority of MNEs would still be governed by the existing rules under current tax treaties. As has been described, the existing rules currently benefit developed countries where highly digitalised MNEs are resident. Pillar One would not cover these MNEs operating in developing countries. Instead, their revenue would still be sourced to the residence country. Therefore, I question how much revenue the new taxing right actually reallocates. I believe that the currently proposed threshold is too high,

[163] George, Libby, "African online retailer Jumia's losses narrow after cost cuts", Reuters, 25 February 2021; Additionally, Hearson uses Jumia's statistics from 2019 in his paper cited Hearson (2020) throughout the thesis.
[164] See Pillar One p. 59.

as it excludes many MNEs that are resident in OECD countries and developed countries, which is to the detriment of developing and non-OECD countries. MNEs that do not have a taxable presence will continue earning profits while not contributing tax revenues to developing countries.

I also believe that a global revenue threshold can be a distorting factor. It could lead businesses to plan around the global revenue threshold, especially businesses near the threshold of EUR 750 million. The threshold may influence business behaviour and introduce new tax avoidance behaviour. Further, the threshold can also discriminate between two different enterprises. For example, two different MNEs that have identical local sales revenue in a market jurisdiction can be treated differently because of the difference in their global revenue. In other words, even if an MNE has ten times larger local sales than another MNE in a market jurisdiction, it can still avoid the application of Pillar One.

The leads to the second threshold, the de minimis foreign in-scope revenue, which further limits enterprises in the scope of the new taxing right under Pillar One. I believe that the threshold can lead to discrimination of MNEs in smaller domestic markets that have relatively larger foreign markets. Further, it is yet not specified how the domestic market is defined.[165] Is it the country with the largest in-scope revenues, or the country where the headquarter of the company is located? The determination of this definition and threshold is largely a political question that the Inclusive Framework has to agree upon. It is important that the definition does not become a target of over-manipulation.

These thresholds in Pillar One significantly impact the revenues that would be allocated to market countries, and therefore it affects its relevance for developing countries. If the two thresholds are set too high, fewer MNE groups will fall within the scope of the new taxing right. Even though the

[165] See Pillar One p. 60.

thresholds are motivated by the administrative compliance burden and costs for both MNEs and tax administrations, the thresholds could be set at a lower number. I believe that a global revenue threshold at, for example, EUR 500 million would still fulfil the consideration of the administrative compliance burden. The current thresholds raise questions about whether the proposal will in fact lead to a change in the international tax regime. This may not be the case if most digital businesses do not fall within the scope of the new taxing right. This leads us to the question of how much additional tax for the amount of complexity that the Pillar One and threshold of EUR 750 million would give. In my opinion, it may lead to little redistributed profits.

The combination of a positive list, a negative list, a general definition, exemptions and thresholds generate additional complexities in the application of the rules, and also as potential tax planning options for enterprises. This can be a challenge for developing countries that have resource-strained tax administrations and lack the necessary resources of skilled personnel.[166] Businesses that are restructuring or corporate reorganisations can result in falling in and out of the scope of Pillar One. Also, the scope and thresholds may lead to enterprises seeing the new rules as sufficiently complex as to change incentives for expansion to foreign markets. Enterprises out of the scope could face initiatives to avoid adapting and changing their business lines in order not to fall into the scope of Amount A.

In my opinion, the current scope outlined in Pillar One is far too limited. It would maintain the existing international tax system, which since its establishment has been in favour of developed countries. Pillar One would create a system that is very complex, which would not be in the interest of developing countries. The scope of Pillar One would need to be implemented by detailed regulations in national laws, despite not all countries having the same capacities. Pillar One would therefore increase the complexity and not deal with the current problems with the international corporate tax system.

[166] See section 1.5.2.

In this context, it is important to note that the United States (US) has earlier opposed to the Pillar One, as it considers that the new taxing right only targets tech giants and therefore disproportionately hits its own companies. The US has in April 2021, under the Biden administration, offered a proposal that would further limit Amount A to just the 100 largest and most profitable companies, regardless of their industry. This is something that the Biden administration argues will resolve long-standing disputes about which companies should be targeted by new global tax rules. [167] The means that the US position in the Pillar One negotiations remains uncertain. I believe that there will be discussions regarding the proposal laid forward by the US, as the OECD surely does not want a withdrawal from the country. A possible withdrawal would put the whole Pillar One on hold, therefore, there is currently a chance that the scope of Pillar One will be further limited.

Article 12B differs by not providing any threshold in accordance with size or profitability. This means that any enterprise that performs ADS will fall into the scope of the Article. In my opinion, the fact that Article 12B has no thresholds regarding the scope results in the proposal being more straightforward in determining if an enterprise will fall into the scope or not. This will also lead to more enterprises being in scope of the Article 12B than in Pillar One, which means that Article 12B would be applicable to both the world's largest MNEs as well as to small and medium-sized enterprises. As more enterprises will be covered, Article 12B would result in a considerable change to the current international tax system. However, I believe that the absence of thresholds raises concerns regarding the administrative burden for both enterprises and tax administrations. As Article 12B currently is designed, it would apply also to small payments. I question whether small payments would outweigh the additional administrative burdens for developing countries.

[167] See Politi, Williams & Giles, "US offers new plan in global corporate tax talks", Financial Times, 8 April 2021; Davison, Gottlieb & Chrysoloras "U.S. Floats Tax Compromise Targeting 100 International Firms", Bloomberg, 8 April 2021.

5.3 Nexus

Both nexus rules in Pillar One and Article 12B are clearly different from the currently existing nexus concept based on physical presence. Pillar One creates a nexus by exceeding an in-scope market revenue threshold. The threshold is motivated by compliance burdens for MNEs and tax administrations in situations of very little benefit.[168] The threshold will, together with the thresholds in the scope, further limit the allocation of taxing rights to market jurisdictions. If the threshold is too high, it will prevent developing countries from taxing profits attributable to their markets.

The market revenue threshold is not yet determined, however, Pillar One states that it intends to protect the interests of smaller jurisdictions, and in particular developing economies, by using a lower nexus.[169] I question whether this means that the threshold will be country-specific, or if there will be two or more different thresholds. The Pillar One suggests indicators such as GDP.[170] This is positive for countries with smaller markets, which also includes developing countries. A high-market revenue threshold would not benefit developing countries with small economy market jurisdictions where sales are naturally lower.

I believe that the possibility of different market revenue thresholds further increase the complexity of Pillar One. A nexus that is the identical in all countries would be easier for MNEs and tax administrations to administer. Instead, there is a risk of greater compliance costs. Also, I consider that there is a risk that enterprises may avoid creating a nexus in smaller jurisdictions as the benefits would perhaps not overweigh being subject to taxation in a jurisdiction where there is a smaller market. However, in my opinion, even if one threshold would be easier, this would not be in favour of smaller jurisdictions and markets which includes developing countries.

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[168] See section 3.3.2.
[169] Ibid.
[170] Ibid.

Further, a nexus in Pillar One is created when there is participation in an active and sustained manner in the economic life of a market jurisdiction. I question this as there is a global revenue threshold. This means that even if an MNE by margin succeeds the market threshold, it is still likely that the MNE does not fulfil the scope and therefore the new taxing right would not be applicable. This can perhaps explain why the phrase "the ability to participate in an active and sustained manner in the economic life of a market jurisdiction", is not provided with a definition.

Article 12B does not contain any threshold or other requirement as a condition for taxation of income from ADS at source to be triggered. Astuti writes that Article 12B therefore could provide for taxing rights in respect of all market jurisdictions, regardless of the amount of sales.[171] Chand and Vilaseca argue that this may lead to disproportionate administrative burdens for both taxpayers and tax administrations and may create an unbalanced playing field for small and medium-sized enterprises with cross-border activities, as they may not have sufficient resources to meet this burden compared to larger MNE groups.[172]

In my opinion, the fact that there are no thresholds results in the determination of the eligible market jurisdictions to be more straightforward. Another positive aspect is that market jurisdictions will not be treated differently according to their market sizes and populations. The absence of thresholds, or for that case different thresholds, will not affect how digital businesses choose to conduct their business in different countries. However, I agree with Chand and Vilaseca that the absence of a threshold will lead to administrative burdens for both enterprises and administrations and that it will not be proportionate for small and medium-sized enterprises, as they do not have sufficient resources compared to large MNEs. However, in this section, I consider both Pillar One and Article 12B resulting in administrative burdens

[171] Astuti (2020) p. 726.
[172] Chand & Vilaseca, "The UN Proposal on Automated Digital Services: Is It in the Interest of Developing Countries?", Kluwer International Tax Blog, Wolters Kluwer, 5 March 2021.

for both enterprises and tax administrations, but Pillar One being more far-reaching.

5.4 Revenue Sourcing Rules

The revenue sourcing rules in Pillar One and Article 12B are very different from one another. Under Pillar One, each category of ADS has its own revenue sourcing rules with indicators. Pillar One has for example technical information on how to obtain adequate data and identify the location of the customers or users.[173] Chand and Vilaseca argue that Pillar One has strong revenue sourcing rules with indicators, which could indeed allocate additional revenues to developing countries.[174]

In my opinion, the revenue sourcing rules outline a number of complex revenue sourcing rules. As has been described earlier, developing countries often have a low capacity to administer international tax rules and audit and monitor MNE's activities.[175] Therefore, I consider these rules, which might be too complex, may be difficult to control for tax administrations and not enforceable in practice, especially for developing countries. Compliance with these sourcing rules would require substantial automation and technology-intensive supervision.

The revenue sourcing rules in Article 12B only sources the revenue to the payer's residence or to a PE or a fixed base. The payments would not be sourced to whom the ADS is delivered. This is different from Pillar One that includes non-paying users in the calculation which may be to benefit of developing countries. As was demonstrated in the two cases, Pillar One would source the revenue from the sale of user data to country B, where the users are located. The revenue from the advertisement would also be sourced to the

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[173] See section 3.3.3.
[174] Chand & Vilaseca, ”The UN Proposal on Automated Digital Services: Is It in the Interest of Developing Countries?”, Kluwer International Tax Blog, Wolters Kluwer, 5 March 2021.
[175] See section 1.5.2.

country where the user is located. However, when applying Article 12B, the taxing right would not be allocated to the countries where the users or customers are located.[176]

Members of the African Tax Administration Forum have reported that only a few payments are currently being made from their countries for digital services and therefore the revenue collection from such payments will be low. Therefore, they consider it vital that a country's taxation rights include revenue that is directly and indirectly attributable to the country from user participation.[177] This view is also shared by the World Bank, which considers that a narrow scope based on "income arising" could disproportionately impact developing countries. This is because while some payments for online advertising will be made by local businesses in developing economies, the payments will often be made by large MNEs with a global footprint.[178]

I share the view above and believe that developing countries would lose a lot of revenue in these cases. In this aspect, Article 12B would lead to lower revenues for developing countries than when applying Pillar One, which would allocate additional revenues with its sourcing rules to developing countries. According to the sourcing rule in Article 12B, developing countries would not have taxing rights even if a digital service indeed has a strong connection to users within the country. In my opinion, as data and user participation are key features of the digital economy, I believe it to be highly important that a country's taxation rights include revenue that is directly and indirectly attributable to the country from user participation.

The commentary to Article 12B states that the revenue sourcing rule is based on administration considerations.[179] I understand this due to the complexity

[176] See the application of Pillar One in section 3.4. and the application of Article 12B in section 4.4.
[177] African Tax Adminstration Forum, "Technical Review of The Draft Article 12B United Nations Model Convention", October 2020, p. 2.
[178] World Bank Group Staff Comments on Proposed UN Article 12B of the UN Model Tax Convention (Automated Digital Services) p. 3.
[179] The 20th Session Report p. 31.

offered in Pillar One. To only source the income to the payer's residence is much less complex and easier for tax administrations and MNEs to comply with. However, in order for Article 12B to also raise tax revenues to developing countries, I believe that the UN Tax Committee should consider other allocation mechanisms. In this part, they can be inspired by Pillar One, but consider possible simplifications of the sourcing rules.

5.5 Profit Allocation

The profit allocation rule in Pillar One taxes business activities in market jurisdictions based on three mechanisms.[180] As neither the profitability threshold nor the reallocation percentage have been agreed upon, its not easy to determine what outcome the allocation would have for developing countries and if it would allocate a significant share to developing countries. Astuti writes that the profitability threshold should not be set too high, as it would reduce the revenue that would be reallocated. In addition, Astuti argues that the reallocation percentage of the residual profit should not be set too low.[181]

The fact that only a share of the residual profits would be allocated, and not the total profits, indicates that the allocation will not be significant. Also, in my opinion, the three-tier mechanism has too high complexity, especially considering that it does not allocate much tax revenue to the market country. The fact that the revenue allocated under Pillar One would only be a share of the residual profits, leads to the questioning of whether Pillar One will offer a long-standing solution for the future as the digital economy is constantly growing. The scope has already limited the number of MNEs, and the profit allocation further limits the possible revenue distribution. This combined with the complexity is not in favour of developing countries, especially the least developed ones.

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[180] See section 3.3.4.

[181] Astuti (2020) p. 728.

The profit allocation rules in Article 12B offers both a gross basis approach and a net basis approach.[182] Chand and Vilaseca write that it can be argued that withholding taxes are a simple and effective method of tax collection imposed on non-residents. However, they consider that gross taxation may lead to excessive taxation.[183] This view is shared by Astuti, who believes that the risk is particularly high if the withholding tax rate is too high, but also considers that the use of a withholding tax mechanism could reduce the administration costs for MNEs and tax administrations alike.[184]

Byrnes argues that a withholding based system may offer simplicity in contrast to the implementation of Pillar One, and recommends a study on a withholding tax approach. He believes that the UN option is rooted in established substantive and procedural withholding norms with corresponding double taxation relief provided by foreign tax credits.[185] O. Teijeiro writes that the treaty-based implementation of a source-based withholding, in line with Article 12B, appears to be an attractive alternative to the OECD's complex and uncertain solution.[186]

I agree that gross basis taxation is in the interest of developing countries as it is a withholding tax that is simpler to implement for tax administrations. Even though there is a risk that it could discourage investments which is much needed for the corporate income tax base, the proposed percentage is rather low. If developing countries use a lower rate of percentage of the gross amount in bilateral negotiations, I believe that the risk of over-taxation will be reduced. Further, if an enterprise is of fear of over-taxation, it has the option to choose to pay tax on the net income approach.

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[182] See section 4.3.4.
[183] Chand & Vilaseca, "The UN Proposal on Automated Digital Services: Is It in the Interest of Developing Countries?", Kluwer International Tax Blog, Wolters Kluwer, 5 March 2021.
[184] Astuti (2020) p. 727.
[185] Byrnes, "Recommendations for the Pillar One and Pillar Two Blueprints", Kluwer International Tax Blog, Wolters Kluwer, 18 December 2020.
[186] O. Teijeiro, "Digital Economy Direct Taxation: A Question of Marketing, Political Muscle, or Practical Merits for Market States", Kluwer International Tax Blog, Wolters Kluwer, 12 February 2021.

The approach would apportion 30% of an enterprise's income from ADS to countries where the revenues from those sales arise.[187] Baker and McKenzie believe that a net income election can relieve the unwarranted tax burden on low margin or loss-making companies, but that relief will come at significant administrative burden.[188] I agree with this view, however, I believe that the allocation of 30% income to be taxed by the market jurisdiction will be greater than the portion of the residual profits that is to be allocated under Pillar One. The net basis option would provide a fairer result for the enterprise than the gross basis option, however, it comes with burdens for both the enterprise and the tax administration.

5.6 Implementation

Pillar One is to be implemented by a multilateral instrument, while Article 12B is to be incorporated in the UN Model.[189] The OECD's solution of a multilateral instrument could be more effective in comparison to a bilateral instrument, as it is a more effective mechanism when all countries sign one instrument. However, the implementation further requires changes in domestic law. I believe that the fact that Pillar One and the new taxing right under Amount A will be an overlay to the existing law, both domestic law and treaty law, leads to further complexity.

Tax administrations will have another layer of rules to deal with operating parallel to the current corporate tax regime. Managing the interaction of the new taxing right with existing rules will add further complexity to the international tax system. In my opinion, in order for Pillar One to undergo an effective implementation, it would require a flexible timeline to adopt the new rules for countries. This is especially important in the view of developing countries as the implementation may take time depending on resources and

[187] See section 4.3.4.2.
[188] Comments from Digital Economy Group (Baker McKenzie) on Proposed UN Article 12B of the UN Model Tax Convention p. 5.
[189] See section 3.3.5 and 4.3.5.

technical expertise. I consider that it is important to question whether the Inclusive Framework can reach a consensus that would lead to an implementation. There is a risk that Pillar One will not be implemented at all, or not implemented in years.

Issakova writes that because of the uncertainties surrounding the OECD Pillar One approach, the new Article 12B might be an attractive option for countries like Kazakhstan in view of its administrative simplicity, enforceability and practicality, even though the suggested approach might only be an interim solution to a modern digital challenge.[190] The African Tax Administration has written that "whilst efforts continue to be made by the OECD Inclusive Framework to develop a consensus-based solution to address tax challenges arising from digitalisation, there is a significant risk for African countries in simply waiting to see whether the OECD Inclusive Framework can achieve an international solution".[191] Astuti writes that a delay may result in an increase in the number of countries having adopted unilateral measures.[192] I also believe it to be inevitable that a failure of Pillar One will encourage countries to take unilateral measures instead in order to raise tax revenues.

In opposite to the implementation of Pillar One, the implementation of Article 12B would require bilateral negotiations with the relevant treaty partners to add Article 12B to the existing treaty or to any new treaty. Chand and Vilaseca consider that Article 12B creates more uncertainty by staying within the existing international tax framework.[193] However, I consider that compared to the OECD solution, Article 12B offers less uncertainty. This is because there would not be two parallel systems running, which is the case of the possible multilateral convention. Article 12B would be incorporated into the

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[190] Issakova (2021) p. 177 f.

[191] African Tax Adminstration Forum, ”Technical Review of The Draft Article 12B United Nations Model Convention”, October 2020, p. 1.

[192] Astuti (2020) p. 721.

[193] Chand & Vilaseca, ”The UN Proposal on Automated Digital Services: Is It in the Interest of Developing Countries?”, Kluwer International Tax Blog, Wolters Kluwer, 5 March 2021.

UN Model, which already contains provisions on business profit articles and the concept of PE. It would not create two systems that operate parallel.

It is important to consider that compared to Pillar One and its multilateral convention, it is both time consuming and requires resources to negotiate bilateral tax treaties. It is also uncertain if the contracting parties can reach an agreement. If developing countries want to implement Article 12B, a lot of time would also be spent trying to renegotiate tax treaties that are already concluded. If the revenue that would come from Article 12B would be low, the cost may outweigh the benefit.

Another question that arises is if developed countries where large digital MNEs are resident would agree to include Article 12B. Mutava writes that attempts by many developing countries to include Article 12A (technical services) in treaties negotiated with OECD countries has met resistance.[194] VanderWolk argues that Article 12B is unlikely ever to apply to payments to the large, global companies at which digital services taxes are aimed. The majority of those digital companies are based in the US, and the US, which opposes digital services taxes and uses its own model tax treaty, would almost certainly never agree to a provision like Article 12B.[195] This view is shared by Baker and McKenzie.[196]

I share this view, partly because of Article 12B's scope which ring-fences highly digitalised businesses. However, as Article 12B does not have any threshold, I consider it to be more neutral in both targeting the largest digital enterprises and smaller digital enterprises. I believe that it does not ”target” only large US' enterprises in the same way as Pillar One. But still, Article 12B would mean that the residence country would have to give up some of its taxing rights, which certainly will meet resistance. However, I believe that

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[194] Mutava, ”What should a 'new deal' on international tax look like for developing countries?”, International Centre for Tax and Development, Blog, 28 May 2020.
[195] VanderWolk, ”Sideshow: The UN Committee of Experts and Digital Services Taxes”, Bloomberg Tax, 5 March 2021.
[196] Comments from Digital Economy Group (Baker McKenzie) on Proposed UN Article 12B of the UN Model Tax Convention p. 3.

the possibility of Article 12B not being included in tax treaties can be weighed against if Pillar One will ever be implemented. Pillar One can not be effectively implemented if not all the countries in the Inclusive Framework sign the multilateral instrument.

Even if developed countries would choose to not include Article 12B, it could instead lead to situations of double taxation. This is because Article 12B also requires changes to domestic law, as it is not possible for a treaty to create a taxing right for a jurisdiction. The taxing right must be created through the enactment of domestic legislation as the power to tax an enterprise is created solely by domestic law.

VanderWolk argues that the UN, through the adoption of Article 12B, is sending a signal to developing countries that do not yet have a digital services tax in their law that they might do well to have one.[197] This view is shared by the World Bank.[198] Astuti writes that a digital service tax could be a quick and intermediate solution as its implementation only requires changes in domestic law. In addition, Astuti considers that as an interim measure, the implementation of a digital service tax could be temporary, and, once a global consensus has been reached, the tax should cease to apply.[199]

I agree that Article 12B may encourage developing countries to enact unilateral digital service taxes. However, it may not be good for the sustainability of the international tax framework, and because of its impact on global investments. As net importers of capital, developing countries are highly dependent on foreign investment.[200] Unilateral measures such as digital service taxes can affect the initiatives of enterprises to invest in developing countries. At the end of the day, the implementation and outcome of Article 12B will depend on the bilateral negotiations.

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[197] VanderWolk, ”Sideshow: The UN Committee of Experts and Digital Services Taxes”, Bloomberg Tax, 5 March 2021.
[198] World Bank Group Staff Comments on Proposed UN Article 12B of the UN Model Tax Convention (Automated Digital Services) p. 1.
[199] Astuti (2020) p. 728.
[200] See section 1.5.2.

5.7 Concluding Remarks

The analysis of the proposals has shown that there are significant differences in the approaches taken by the OECD and the UN. As the key aspects of Pillar One are not yet agreed upon and several issues are yet open, it is not simple to determine if the proposal would offer sufficiently more tax revenues to developing countries. All thresholds used for Pillar One are highly important for developing countries when considering if signing the possible future multilateral instrument.

From the concept of inter-nation equity, Article 12B is the proposal that favours developing countries. This is because I believe that Pillar One would in effect lead to increased complexity of the international tax system, partly because the new rules are expected to apply on top of the existing rules, both domestic law and treaty law. I find it difficult to see how the new multilateral instrument will interact with the existing rules in the OECD Model. In my opinion, managing the interaction of the new taxing right with the existing rules, would add further complexity to the international tax system and be a challenge even for the tax administrations in the most developed countries. Further, due to the limited scope, all the thresholds and only a share of the residual profit being subject to reallocation, I believe that it would not result in a fundamental reform. Instead, it would require significant resources for tax administrations to both comply with and administer. In summary, Pillar One would not lead to significant reallocation of tax revenues, but it would add complexity and a heavy administrative burden to the international corporate tax system.

The UN has offered a simple solution in a short period of time. However, Article 12B also has flaws and its own disadvantages. An important disadvantage of Article 12B is that the sourcing rules apply without taking into consideration the location of users and is instead focused on payment location, as opposed to where the services are rendered. I believe this is not

in favour of developing countries. However, due to the scope not having thresholds and the share not being limited to the residual profit of an MNE group, I believe that Article 12B may provide more tax revenues while also being overall simpler to administer.

Can a bilateral provision solve a multilateral problem? In my opinion, Article 12B currently seems to be the only solution compared to unilateral measures. At least until there is a multilateral solution globally agreed upon. Even if the implementation of Article 12B is less effective than a multilateral convention, it is still better than a situation with no multilateral convention and countries taking uncoordinated unilateral measures. Therefore, from the concept of inter-nation equity, developed countries should consider an inclusion of Article 12B in their tax treaties with developing countries. Even if only until there is an agreed multilateral approach. Every day that passes results in developing countries being deprived of well-needed corporate income taxation from MNEs operating within their borders.

6 Concluding Analysis

6.1 Introduction

This chapter seeks to provide a more extensive discussion of the current international tax regime, while not necessarily focusing on specific legal issues. The purpose of the chapter is to present my concluding reflections on the important issues that currently exist in the international tax regime and open a discussion of the future direction. The last part of the chapter aims to summarise the analysis that has been carried out continuously throughout the thesis and draw a conclusion based on the findings in the thesis.

6.2 Mapping Out Present and Future International Taxation

Currently, we are amidst the biggest change in decades in the way that MNEs are taxed. The solutions that have been put forward go beyond some of our fundamental principles that have underpinned international corporate taxation for a century. As developing countries historically have been disfavoured in the establishment and development of the international tax regime, the taxation of the digital economy offers a chance to change the unjust system that developing countries have been subject to.

In my opinion, the differences between Pillar One and Article 12B clearly show the fundamental differences between the OECD and the UN as actors in the international tax arena. Further, it contributes to the issue regarding if there is a possibility of reaching a global consensus on taxing the digital economy. As Pillar One currently looks, it is not designed to "redesign" the current international tax regime. It is an own solution that would be added on top of the current rules. I do not see Pillar One as a fundamental reform, but rather a solution to the taxation of digital services. If Pillar One would be implemented, I believe that it would prevent, for a long time being, the discussions on the general division of taxing rights between residence and

source countries. Further, it would strengthen the dominant role that the OECD has in the standard-setting of international taxation rules.

During my research, the clear majority of the literature and articles describe the taxation of the digital economy as urgent, particularly for some specific countries. However, the issues are described and debated without exposing the overall residence and source balance to a critical debate. The Pillar One proposes a new taxing right for market jurisdictions without seeking to examine the balance between residence and source taxation. If taxing the digital economy only was an issue for developing countries, I do not believe this thesis would have been written.

As has been described, the Inclusive Framework is not as inclusive as one might believe. I believe that it is natural for the OECD to primarily preserve the interest of its members. Even if a global consensus is admirable, a system that is strongly dominated by the interest of OECD member countries is not. For Pillar One to be acceptable, it has to reflect the interest and needs of all countries and not just the member countries. If not, there is a chance that Pillar One may be ignored by developing countries.

The countries of the Inclusive Framework are yet not aligned on important parts of Pillar One, which makes me believe that a consensus-based solution to issues regarding taxation of the digital economy can hardly be expected. The digital economy affects countries differently, and countries do often not share a common interest as they have different needs and capacities. This is why I find it difficult to see that the Inclusive Framework can arrive at a satisfactory outcome which genuinely contemplates the national interests of all countries, especially the developing ones. The fact that different powerful countries around the globe have to agree is one reason that makes me question what the evolving proposals can deliver to developing countries.

In my opinion, the UN has presented a solid proposal in a short amount of time. The main problem is, however, the enormous influence that the OECD

has in the international tax arena, which perhaps is why the UN proposal has not received as much attention as Pillar One. I strongly believe that the reception by the tax community would be different if the proposal was presented by the OECD. Even though I believe that the UN is the only truly universal body, I also believe that there can or will not be another policy actor in the international tax arena that can threaten the OECD's position. However, I see it as positive that another policy actor in the international tax arena puts forward its own proposal, and does not stand and wait for the OECD's solution. Further, the continued work in the UN may perhaps influence the work of the OECD, especially in terms of simplicity, needs and urgent tax issues of developing countries.

I recognise that it is very difficult for both the UN and the OECD to develop instruments that are addressing different priorities of different countries that includes different approaches. However, I believe that it is in the best interest of both developing and developed countries to participate in multilateral efforts to solve the tax challenges of the digital economy. This does not mean that I consider Pillar One to be the solution, instead, I believe in further negotiations and discussions. I understand that there is an urgent need to collect tax revenues, especially during the ongoing pandemic. This being said, I advocate for not rushing the process in order to reach a multilateral solution that can stand for the long term and benefit all countries, both the developing and developed ones.

I hope this thesis can initiate further research into urgent tax challenges for developing countries and how global tax challenges affect developing countries, especially the least developed ones. This issue deserves more attention than can be given in this thesis. I believe that the BEPS project that we have seen in the last decade has focused on important tax challenges for the developed world. However, I believe it is time to shift the focus to tax challenges facing the developing world. Even though it may not be a priority for the developed world, the time has come to develop the international tax

regime to take into account the different needs and capacities of all countries. Not just the developed ones.

6.3 Conclusion

The purpose of this thesis was to examine and identify the differences and similarities between Pillar One and Article 12B. The purpose was also to determine which of the proposals is in favour of developing countries by applying the concept of inter-nation equity. The lack of details in Pillar One has limited this thesis' findings to be only general and tentative. Based on the analysis presented above, my conclusion is that Pillar One and Article 12B are very different in almost all key aspects. From the concept of inter-nation equity, I argue that Article 12B is in favour of developing countries with regard to simplicity and raising tax revenues.

The proposals aiming at addressing the tax challenges brought by the digital economy indicate an opening from the well-established principles and traditions in the international tax system. The digital economy is an opportunity to reform the international tax system, and not only in favour of developed countries. Therefore, a sustainable and long term solution that reflects the diverse needs and capacities of all countries is vital.

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