TAX AND THE DIGITAL ECONOMY - WILL PILLAR ONE BE THE SOLUTION?

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1. Introduction

For those who are not fully introduced into international taxation, please don't worry. The digital economy is not going to kill the 'Alp's, at least not to my knowledge. In international taxation, ALP stands for Arm's Length Principle, which is an instrument that helps to determine how profits will be divided within a group. To determine a precise Arm's length price is not an easy exercise. OECD's TP Guidelines and the UN's Transfer Pricing Manual cannot be perceived as easy readable information guidelines, still they are being perceived as THE tools to get an intragroup price which is as close as possible to an intragroup price that is, as being demanded, at arm's length. That criterion 'arm's length' is relevant since within a group of companies pricing can be influenced. Serving intra group clients without having any rules in place is just something else than serving external customers. By testing the 'arm's length principle', there is a reasonable certainty that an intragroup price has been set which is in line with what that service would have cost a third party.

In the meanwhile, the world is changing. The European Union strives for getting a pan-European formulary apportionment system to be accepted,[3] and the US tax rules since 2018 also go beyond the ALP with for example a global minimum tax.[4] Due to recent plans from the OECD to tax companies in the digital economy, 'formulary

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3 https://ec.europa.eu/taxation_customs/business/company-tax/common-consolidated-corporate-tax-base-ccctb_en

4 https://www.irs.gov/newsroom/irs-and-treasury-issue-guidance-related-to-global-intangible-low-taxed-income-gilti

apportionment' will get much more important.[5][6] Formulary apportionment is based on a system which departs from determining the global profits of a company, which are then apportioned to all states in which the company operates based on certain allocation factors. But is this the better solution? Will formulary apportionment ignore all the disadvantages created by ALP and just be the better solution? That is the question. A few weeks before I tried to finish this contribution, the OECD published a new consultation paper regarding the digital economy, the so-called unified approach.[7] Since the previous report led to too many discussions between some of the bigger OECD Members, the OECD is trying to define a compromise which is acceptable for all.

In this contribution, I will discuss the developments with respect to the digital economy and what it will mean for the international tax practice. The main focus will be on the 2019 reports since in those reports the OECD tries to find its way within solutions which have amongst others the characteristics of formulary apportionment. And, after being accepted, this would probably create the biggest change in international tax rules in close to 100 years.

Whether the countries of the world will choose a formulary apportionment system as mentioned in the March 2019 report, the system from the October 2019 report, or all go their own way by applying an equalisation levy, still it is clear that none of them will be perfect from the perspective of companies. It can be foreseen that companies will suffer (to say the least) from a new era of uncertainty. They will certainly experience a higher tax burden[8] and a strong increase in tax cases around the globe.

2. Why is the world in need for a change?

What company does the reader believe is the most valuable company of the world? Mercedes-Benz or Alphabet? Many readers will probably think: 'Alphabet, what is this company doing?'. Well, this company operates brands like Google and YouTube. Alphabet is an exponent of the new economy. And perhaps surprisingly, Alphabet is here the most valuable company of these two. And that is not just one example. There are more examples where the new economy outperforms the old one. In the last two decades, the world saw an enormous change in the value of companies from the old economy versus those from the new economy. In any Top Ten of the most valuable

5 OECD does not speak of formulary apportionment, but mainly of fractional apportionment and revised profit split. Both systems will lead to the effect that the profit is going to be apportioned more and more, however.

6 http://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf

7 http://www.oecd.org/tax/oecd-leading-multilateral-efforts-to-address-tax-challenges-from-digitalisation-of-the-economy.htm published on October 9.

8 With which is nothing wrong provided that this will not lead to unresolvable double taxation.

companies in the world we will find companies which were hardly known or not known at all a couple of years ago. Companies like Amazon, Alphabet and Facebook demonstrate that business models of companies have changed a lot.[9] Those Top Ten lists of the most valuable companies do neither include companies like Boeing or General Electric nor European players like Siemens or BMW. These are still strong multinationals, but with all their strength, the digital companies have kicked them out of the Top Ten. It is clear that the majority of the most valuable companies in the world are younger companies with a relation to the digital economy. And that is probably not going to change anymore.

Since these newer digital companies are the money-makers of this world, new problems have arisen. States want their piece of the cake, which is a more than reasonable desire. The current international tax rules and principles do not really offer any means for states to accomplish this. For example, how can Germany tax the profits realised by Facebook in Germany? And what about the companies which use Facebook as a sales channel around the globe? In those situations, the difficulties are even worse. Current international tax rules hardly offer help in taxing those companies, which do not have any taxable base (nexus) in many of the states where they generate their profits. What these difficulties are, can quite clearly being demonstrated with an example.

Example Amazon:

A company like Amazon makes major sales in the Netherlands and mostly non-digital products, but can the connected profit being taxed in the Netherlands? First of all, there is no subsidiary from Amazon in the Netherlands, so there is no resident taxpayer. But perhaps there is a permanent establishment or as we say in tax terms a ‘non-resident taxpayer’? In order to have one, Amazon should use a fixed place from which the Dutch business is carried on. But there is no activity at all. In theory, Amazon could have a construction permanent establishment or a dependent agent permanent establishment, but we can ignore that position.[10]

It is clear that Amazon makes a lot of money in the Netherlands but that the Netherlands cannot tax any corporate income tax. The only connecting element is the value added tax. Within the European Union the solution is found in levying a corporate income tax based on revenues, the so-called equalisation levy. But by writing this, it becomes clear that this is a strange solution, namely levying a direct tax which in fact is an indirect tax. And this is just one of the reasons why not all EU Member States embrace this solution.

9 See for an example: https://www.cnbc.com/2019/06/11/amazon-beats-apple-and-google-to-become-the-worlds-most-valuable-brand.html

10 Art. 5.3 permanent establishment and art. 5.5 permanent establishment.

3. The European Union initiative

As a consequence of the above mentioned considerations, the Netherlands can neither tax Amazon nor companies using Amazon as its sales platform provided that none of these have nexus (i.e. a taxable activity) in the Netherlands. This has led to many discussions and suggestions for solutions, amongst others within the European Union.[11] In the European Union some states have suggested to the European Commission to come up with a proposal (directive) for a so-called equalisation levy. This is mainly a sort of corporate income tax based on annual revenues.[12] The European Commission with support from the European Parliament has become a strong promotor for this new tax.[13] States where earnings are being made, would under this system be able to also tax those earnings, but in an indirect way.[14] And it is this indirect way which creates some fog. The form of this new taxation is not easy to comprehend under current international tax rules if it is comprehendible at all. The tax is rather based on revenues. But should a tax based on revenues not be considered a VAT? I tend to think so. The least what can be concluded is that this hybrid tax system is difficult to qualify and qualification of a tax is essential for companies for amongst others double tax relief. This diffuse approach for a new corporate income tax is also the reason why many EU Member States do not support this system. In my humble opinion I like to refer to the expression 'if it looks like a duck, it sounds like a duck and it walks like a duck, it might as well be a duck' but this saying is apparently not known by the European Commission.

And by just writing this, it is clear that this hybrid tax approach will create a lot of new problems. The main problem is of course that not all digital companies are as successful as Amazon is. It is known that a European digital company like Spotify has hardly made any profit. But since they are operating around the European Union and most people use the platform, based on this new 'revenue taxation approach', Spotify will have to pay taxes in all countries possibly from 2020 on. And that goes also for the years they did not make a profit at all. And then the question will arise whether Sweden, where Spotify's headquarters is based, can help Spotify to solve the issue of undergoing double taxation. But even if the Swedish government would be willing to give a tax credit (although it is not clear on what basis) the next question is against what since the company does not make a profit? So, if we want to make the European

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11 https://europa.eu/rapid/press-release_MEMO-17-3341_en.htm
and see also,
http://www.europarl.europa.eu/legislative-train/theme-deeper-and-fairer-internal-market-with-a-strengthened-industrial-base-taxation/file-digital-services-tax-on-revenues-from-certain-digital-tax-services/03-2018

12 https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_common_system_digital_services_tax_21032018_en.pdf

13 http://www.europarl.europa.eu/RegData/etudes/BRIE/2018/625132/EPRS_BRI(2018)625132n_EN.pdf

14 The profit is not being taxed but a percentage on the sales.

Union a relevant competitor for US and Chinese digital companies[15][16], by creating a fruitful environment for digital start-ups, this will not be the way forward.

For countries like Sweden this new taxation is a no go. But also other states are of the impression that by introducing this levy new start-ups would fail to be able to grow rapidly and build within a reasonable couple of years a base like US digital companies have. It actually imposes disproportionate tax burdens on these initiatives and that seems quite counterproductive. Disproportionate since it cannot be explained under the current tax rules that digital companies which are hardly profitable and even mostly lossmaking during often a longer period of (start-up) years, still have to pay taxes in all states where they are active. Despite this fact, countries like France[17] and even the United Kingdom have introduced comparable tax systems to be able to tax foreign digital companies which do business in their countries. The equalisation levy is by the way not a typical EU initiative. Many states around the world including India and Australia have introduced or will introduce comparable levies. The tax rate in India, with a few exceptions, is even 7%.[18]

I truly believe that all these new taxes will affect new innovative companies in a negative way in their growth and will certainly be a disaster for the position of the EU as the place to develop new digital companies.[19] But since direct tax directives still have to be concluded under unanimity and several states where against the European Commission's initiative, it has not yet been accepted.

Where France and the UK introduced initiatives based on the European Commission proposal, other states go now on their own.[20] One of these is Italy. In October 2019, it was announced that Italy is going to sue Netflix for tax evasion. Italian prosecutors are investigating Netflix Inc. after the U.S. streaming company failed to file a tax return, according to people familiar with the matter. The Milan tribunal has opened the probe as the prosecutors believe Netflix has sufficient physical presence in Italy -- including fiber optic cables and servers -- to be recognised and qualified as a local

15 https://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf

16 As an example Alibaba can be mentioned.

17 See amongst others https://www.reuters.com/article/us-france-tax-usa/u-s-tech-industry-leaders-french-digital-service-tax-harms-global-tax-reform-idUSKCN1V91UC
and the response from the US and also
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752172/DST_web.pdf

18 See:
https://www.ictd.ac/blog/taxing-digital-transnational-corporations-indian-policy-initiatives/

19 See a.o. https://ec.europa.eu/jrc/en/research-topic/digital-economy and many other links in this page

20 That is to say, they will also introduce an equalisation levy but they also use other means.

business that should be paying taxes, said the people interviewed by Bloomberg, who apparently asked not to be named as the investigation is not public.[21]

Can Italy do this? No, to my opinion Italy cannot. Italy is an OECD-member state and therefore Italy should follow the OECD Model Tax Convention. Based on this a server is in principle not a permanent establishment if the server is not owned by the company.[22] In theory, a server can be a permanent establishment under certain specific conditions, but not under the condition that this rented server is a gateway to many sales. Moreover, I assume that the tax treaty between Italy and the United States is based on a previous model tax convention, which had a much more limited commentary and based on this, Italy should remain with empty hands.[23] And besides that, although the commentary to the OECD Model Tax Convention rejected the position that a server can be a permanent establishment, Italy could have made a reservation with respect to this on the commentary but did not do so. So if we assume Netflix has rented Italian servers, these servers are not at the disposal of the enterprise. But all these arguments are, unfortunately, not relevant for Italy. Italy does not really care and believes it can tax servers and fiber optic cables as if these are permanent establishments. The only way Italy could win this case with their courts is when the Italian courts just interpret the text of the treaties on their own and do not use the commentary as an explanatory mean. The text is quite open but the meaning is in the commentary. But if you ignore the latter, the world is open.

Fiber optic cables is possibly another issue. It could probably best be compared to pipelines. Within the European Union, only Germany has its position to pipelines. Germany considers a pipeline of an oil company as a permanent establishment and therefore made a reservation under the MTC. Italy did not. So, in principle Italy should follow the main rule which is that a pipeline (or compared to this case fiber optic cables) cannot be a permanent establishment. So will Netflix win the case? I am afraid not, and by writing this I am without doubt creating confusion to my readers. Did I write that Italy has no argument and I still believe Netflix will lose the case? Yes, I do. The reason for this is that running a tax court case in Italy is, to say the least, difficult.[24] [25]And, as stated above, Italian courts can ignore the commentary and simply create their own interpretation of what a permanent establishment is. In that situation, Netflix will incur double taxation since it is doubtful whether a qualification

21 https://www.bloomberg.com/news/articles/2019-10-03/italy-said-to-investigate-netflix-for-failing-to-file-tax-return

22 See par.122 and further from OECD's Model Tax Convention's Commentary as updated in 2017.

23 Again, this is the reason that there should be a global solution for taxing the digital economy but the fact that there is no solution yet is no reason to ignore treaty rules.

24 See amongst others Hans van den Hurk, Tax Planning, Ethics and Our New World in IBFD's Bulletin 2018 (volume 72), nr. 2.

25 See also: https://www.internationaltaxreview.com/article/b1gtv499mqwm7q/italian-supreme-courts-controversial-ruling-on-the-parent-subsidiary-directive.

issue, as the one in stake here, can be solved by requesting a mutual agreement procedure under the tax treaty.[26]

4. The many OECD initiatives

4.1 Introduction

It is clear that the world is looking at the OECD to come up with a workable solution for all the above mentioned problems which justifies the interests of all participating states. It is not that the OECD did not try to change the world. The OECD started already before the BEPS plans were launched (for the first time in 2013) but they failed to touch base. By introducing Action 1 in 2013, the subject received for the first time serious attention, although Action 1 did not offer any concrete solution. The final report of 2015 did not really do better. Reference was made to indirect taxes and amongst others Action 7[27] and Actions 8-10[28]. But the solutions were far from revolutionary.

2019 was the year in which OECD proposed a real change in the international tax rules. The consultation report 'The Tax Challenges of the Digitalisation of the Economy' was published.[29] It included some radical reforms which dealt with the main point of discussion in international taxation since 1923, namely the arm's length principle. Nowhere are the weaknesses of the arm's length principle more clear than where services in one economy are delivered through virtual platforms located in others. Since there is no nexus the arm's length principle can not be applied. So the main question is: will the arm's length principle survive the digital economy?

In the words of Tax Justice Network:

> "*There is now widespread recognition that BEPS has failed to curtail multinational tax avoidance to a significant degree – and that this failure was largely inevitable from the moment that OECD member states insisted on maintaining the arm's length principle as the basis for international tax rules. Barely was the ink dry on the final BEPS report published in 2015, when the US had entered policy dialogue about the major 2017 reform that goes far beyond the arm's length principle; and the EU had renewed its intention to*

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26 Before the Multilateral Instrument the MAP was not always an instrument to solve qualification issues. Germany accepted this but for example the Netherlands not. After the MLI the MAP is open for qualification issues.

27 Permanent Establishments.

28 Transfer Pricing.

29 https://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf

> *introduce a unitary approach through the Common Consolidated Corporate Tax Base proposals*."[30]

To make this TJN long story short, ALP should not survive the digital economy, at least not in the way as we know it today. And they refer to a trend. The US system since 2018 does include features which go beyond ALP. And the pan-European CCCTB system is indeed based on formulary apportionment but has not been accepted yet since, amongst others, countries with a lot of R&D will lose tax revenues.[31]

4.2 The March 2019 proposals[32]

4.2.1. Introduction

So, apparently the OECD wanted to go for a solution which has the characteristics of a more formulary apportionment system. Unfortunately, the OECD prevued difficult discussions and therefore came up with three alternatives from which the participating countries should preferably choose one. OECD requested the input of a number of relevant countries. The group, the Inclusive Framework is comprised of in the meanwhile 137 countries that broadly represent the different sensitivities of nations, including countries from the G20, G7, non-G20/OECD countries, developing countries, and small, open economies. The steering group consists of 24 states. Members include Jamaica, Senegal, Ivory Coast, Georgia, Belgium, the Netherlands, Singapore, and Sweden.[33] The three proposals have been articulated to develop a consensus-based solution on how taxing rights on income generated from cross-border activities in the digital age should be allocated among countries – namely, the "user participation" proposal, the "marketing intangibles" proposal and the "significant economic presence" proposal.

These proposals, although focusing on the same kind of businesses, have important differences including the objective and scope of the reallocation of taxing rights – hereafter, the "new taxing right" – and the consequences for the current transfer pricing system. At the same time, they all have in common that they allocate more taxing rights to the jurisdiction of the customer and/or user – also called "market jurisdictions" – where value is created by a business activity through (possibly remote) participation in that jurisdiction. In most situations, this value creation is not recognised in the current framework for allocating profits. Further, the three

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30 http://www.oecd.org/tax/beps/public-consultation-tax-challenges-of-digitalisation-13-14-march-2019.htm

31 Unfortunately I cannot dive into that subject here since my contribution would end up with the double number of words.

32 In this paragraph I will cite next to my own vision from the report mentioned in the previous footnote.

33 https://www.oecd.org/tax/beps/steering-group-of-the-inclusive-framework-on-beps.pdf

alternatives have important common policy features, as they all create a solution for not being able to define nexus where there is an absence of physical presence, but still create taxing rights. This has been done by using the total profit of a business, contemplate the use of simplifying conventions (which means that the current arm's length principle will by diverged under certain circumstances) and reduce compliance costs and disputes. These last aspects are a main worry for the OECD, since the OECD recognises that these new systems create a lot of uncertainty and an increased possibility for tax disputes. It is for this reason that OECD refers to its ICAP program[34] as a possible solution for increased controversy.[35] I am not really convinced that the ICAP program will offer a decent solution for these load of new cases. ICAP as such is more a sort of 'horizontal monitoring' system and would to my opinion only solve tax controversy issues if all countries participate and use the same system.[36] Later I will explain why a modified ICAP program could work. Below I will summarise the three systems from the March 2019 paper.[37]

4.2.2. System 1. User participation

This proposal focuses on the value created by certain highly digitalised businesses through developing an active and engaged user base, and soliciting data and content contributions from them. This proposal is based on the idea that soliciting the sustained engagement and active participation of users is a critical component of value creation for certain highly digitalised businesses. The activities and participation of these users contribute to the creation of the brand, the generation of valuable data, and the development of a critical mass of users which helps to establish market power. It contemplates that this source of value is most significant, on an absolute basis and relative to more traditional drivers of business value, for business models like social media platforms, search engines and online market places.[38]

In order for these new rules to become effective, OECD suggested that new profit allocation rules have to be developed. The proposed solution was that the profit allocated to a user jurisdiction, in respect of the activities/participation of users, should be calculated through a non-routine or residual profit split approach. This approach can be divided in four steps:

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34 See: http://www.oecd.org/tax/forum-on-tax-administration/international-compliance-assurance-programme.htm

35 https://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf , Paragraph 84.

36 Otherwise a deal is being made between State A and State B but non participating State C gets less in comparable circumstances and as a consequence the worst deal for the company and its home state will be the preferred deal for the market jurisdictions.

37 As described above and explained below OECD in the meanwhile came up with an alternative.

38 Instagram, Google and eBay to name just a few.

1. Calculating the residual or non-routine profit of a business, i.e. the profits that remain after routine activities have been allocated an arm's length return;
2. Attributing a proportion of those profits to the value created by the activities of users, which could be determined through quantitative/qualitative information, or through a simple pre-agreed percentage;
3. Allocating those profits between the jurisdictions in which the business has users, based on an agreed allocation metric (e.g. revenues); and
4. Giving those jurisdictions a right to tax that profit, irrespective of whether the business has a taxable presence in their jurisdictions that meets the current nexus threshold.

Under this approach, the profit attributed to the routine activities of an MNE group would continue to be determined in accordance with current transfer pricing rules. However, the non-routine profit will undergo a different treatment where they will be recalculated whereby more of it will be allocated to the countries in which the users are located

4.2.3. System 2, Marketing Intangible

The marketing intangible system differs from the previous system, since it is a system that takes into account the broader impact of digitalisation on the economy. In a few words, System 2 focuses on situations where a multinational can "reach into" a jurisdiction, either remotely or through a limited local presence (such as an LRD), to develop a user/customer base and other marketing intangibles. It sees an intrinsic functional link between marketing intangibles and the market jurisdiction. This intrinsic functional link is seen as manifested in two different ways. First, some marketing intangibles, such as brand and trade name, are reflected in the favourable attitudes in the minds of customers and so can be seen to have been created in the market jurisdiction. Second, other marketing intangibles, such as customer data, customer relationships and customer lists are derived from activities targeted at customers and users in the market jurisdiction, supporting the treatment of such intangibles as being created in the market jurisdiction.[39] In its report, the OECD explains that one of the main issues with respect to marketing intangibles is that states can have different interpretations of it.[40] It is clear that by saying so, the consequences for companies is to say the least, complex. It is for this reason that the US is not a real warm supporter of this system.[41] One of the main objections against this system is that it can also be applied on regular companies. So, also companies outside the digital economy.

39 Par.31 of OECD's report.

40 Specifically the relation to trade intangibles is a diffuse one. See https://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf page 13.

41 See later.

How does it work? Taking into account the link between marketing intangibles and the market jurisdiction, the proposal would modify current transfer pricing and treaty rules to require marketing intangibles and risks associated with such intangibles to be allocated to the market jurisdiction. Therefore, the market jurisdiction would be entitled to tax some or all of the non-routine income properly associated with such intangibles and their attendant risks, while all other income (routine income) would be allocated among members of the group based on existing transfer pricing principles. As a consequence market jurisdictions would be given a right to tax highly digitalised businesses – even in the absence of a taxable presence – given the importance of marketing intangibles for such business models.

4.2.4. System 3, Significant Economic Presence

Under this proposal, a taxable presence in a jurisdiction would arise when a non-resident enterprise has a significant economic presence on the basis of factors that evidence a purposeful and sustained interaction with the jurisdiction via digital technology and other automated means. Revenue generated on a sustained basis is the basic factor, but no profit can be allocated under current rules. Only when combined with other factors would revenue potentially be used to 'create' nexus in the form of a significant economic presence in the country concerned. In this context, one or more of the following factors may be considered relevant for creating significant economic presence:

(1) the existence of a user base and the associated data input;

(2) the volume of digital content derived from the jurisdiction;

(3) billing and collection in local currency or with a local form of payment;

(4) the maintenance of a website in a local language;

(5) responsibility for the final delivery of goods to customers or the provision by the enterprise of other support services such as after-sales service or repairs and maintenance; or

(6) sustained marketing and sales promotion activities, either online or otherwise, to attract customers.

The proposal contemplates that the allocation of profit to a significant economic presence could be based on a fractional apportionment method. This would require the performance of three successive steps:

1. the definition of the tax base to be divided,
2. the determination of the allocation keys to divide that tax base, and
3. the weighting of these allocation keys.

The tax base could be determined by applying the global profit rate of the MNE group to the revenue (sales) generated in a particular jurisdiction. The tax base would be apportioned by taking into account factors such as sales, assets and employees. In addition, this proposal contemplates that for those businesses for which users meaningfully contribute to the value creation process, users would also be taken into account in apportioning income.

4.2.5. Why did these proposals fail?

Apparently there were many issues for which an agreement could not be reached, and also the discussion about winner states versus loser states gets a new dimension. The United States, which is not part of the MLI, but still a strong influencer, prefers the User Participation method while the United Kingdom (apparently politically stronger than expected within the EU) seems to prefer the significant economic presence system and again other states fancy the Marketing Intangible system. How more divided can the world be?

Treasury Deputy Assistant Secretary for International Tax Policy L.G. “Chip” Harter said that worldwide agreement on new profit allocation rules is essential to stop the international tax system from descending into chaos as countries increasingly adopt unilateral measures. He said that many countries will not agree to proposals sought by market countries to dramatically alter the profit allocation rules, though, and therefore less ambitious proposals should be considered.[42]

Harter also said that while the work plan presents three proposals for allocating additional taxing rights to market jurisdictions, only one of these “pillar one” proposals has a chance of being adopted. This proposal, the “modified residual profit split method,” is what is described above as the User Participation proposal. Since system 2 (Marketing Intangible) creates new nexus by using the Fractional Apportionment method, it is favoured by many other states, including India. It is not difficult to predict the consequences, a solution is far away. In a very fast response, the OECD recognised that they were not really going into the right direction. In May 2019, they presented a new approach.

5. The May 2019 Report

On May 31, 2019, the international community has agreed on a road map for resolving the tax challenges arising from the digitalisation of the economy, and committed to continue working toward a consensus-based long-term solution by the end of 2020. The 129 members of the OECD/G20 Inclusive Framework on Base Erosion and Profit

42 Quote from Julie Martin, MNETAX.com who attended June 3 the 2019 OECD International Tax Conference in Washington.

Shifting (BEPS) adopted a Programme of Work laying out a process for reaching a new global agreement for taxing multinational enterprises.[43]

A two pillar system was created. In the Policy Note Addressing the Tax Challenges of the Digitalisation of the Economy, approved on 23 January 2019, the Inclusive Framework agreed to examine and develop these proposals on a "without prejudice" basis. These proposals were grouped into two pillars which is intended to form the basis for consensus:

- Pillar One focuses on the allocation of taxing rights, and seeks to undertake a coherent and concurrent review of the profit allocation and nexus rules;
- Pillar Two focuses on the remaining BEPS issues and seeks to develop rules that would provide jurisdictions with a right to "tax back" where other jurisdictions have not exercised their primary taxing rights or the payment is otherwise subject to low levels of effective taxation.

In this contribution, I will only focus on Pillar One. Allocation of taxing rights is a game of give and take. Any of the previously discussed three systems contains in one way or another some characteristics of formulary apportionment.[44] By doing so, the OECD supports the many states that want to tax profits which under the current systems cannot be taxed. The timeline agreed in the G20 is to develop a consensus-based solution by the end of 2020. This seems to be quite ambitious given the need to revisit fundamental aspects of the international tax system. Though it can be explained by the political imperative that all members of the Inclusive Framework seem to be looking forward to finding a timely resolution of the issues at stake. But, as said, redefining allocation criteria is a matter of give and take and giving is not something many states are good in.

The main gamechanger in the May report are the different proposals for a new nexus approach. One of the elements OECD is considering is a change of article 5 and 7 of the Model Tax Convention. In the words of the report: "*Amending Articles 5 and 7 of the OECD Model Convention to deem a PE to exist where an MNE exhibits a remote yet sustained and significant involvement in the economy of a jurisdiction and to accommodate the new profit allocation rules*."[45] By doing so, OECD would remain in the current system without having to come up with new alternatives outside the system.

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43 https://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.pdf

44 Fractional apportionment and revised profit splits can be perceived to be synonyms.

45 In Hans van den Hurk, Tax Planning, Ethics and Our New World in IBFD's Bulletin 2018 (volume 72), nr. 2, I already suggested that an additional paragraph in line with art. 5, 6 of the UN MTC could do the job. It might be that the new OECD's development is going into this direction.

Another approach could be that a new standalone provision will be introduced; giving market jurisdictions a taxing right over profits allocated to them under the new profit allocation rules, which would require:

– identifying and defining a new non-physical taxable presence separate from the PE concept;

– identifying and defining a new concept of income taxable in the source jurisdiction (i.e. income derived from a particular source in a jurisdiction); and

– the interaction between the new taxable presence or source income and existing provisions (including especially provisions governing non-discrimination).

I would prefer a solution in line with a change of Art. 5 and 7 for many reasons. The main reason is that, although there are many differences in the business model of Siemens compared to Alibaba, none of them justifies a total new system next to the other. By adding a new nexus point to the permanent establishment definition, the OECD clarifies those similarities and differences in a comprehensive way. That does not mean that by doing so, all problems will be over. One of the main issues with all formulary apportionment systems is that R&D is a main value driver and that the state in which the value is being created should have a taxing right on the outcome of this value driver, which they don't have for example under the proposed CCCTB system for the European Union. But still, by creating an alternative in line with Art.5 and 7, companies are all taxed under the same rules with an additional nexus for digital companies and since it is based on the permanent establishment provision, double tax relief under a bilateral convention is safeguarded.

6. The Consultation Paper of October 9, 2019

6.1. Introduction

On October 9, 2019, a new consultation paper was published requesting interested parties to comment on a new approach for Pillar One. Apparently, the OECD members could not find a compromise in the three previous mentioned alternatives from the OECD.[46] As mentioned, the United States preferred the User Participation proposal while India and many other states wanted the Significant Economic Presence model. And where sometimes countries take time to find a solid solution, in this situation after a few months countries decided that a solution within these three alternatives was just impossible. Therefore, the OECD came up with new plans to find another way out of this box to solve this impasse.

46 From some 'bigger' states it is known what their preferences are, since they need to give up main taxing rights. This cannot be said from many other states from this Inclusive Framework.

6.2. The new approach

Point of departure for the new rules are the three alternatives as discussed above. Although it seemed to be impossible to come to an agreement, these three alternatives had a few elements in common. All of the three would reallocate taxing rights in favour of the user/market jurisdiction. They are also all based on a new nexus approach that is not based on physical presence in the user/market jurisdiction. Where the current transfer pricing systems are based on the arm's length principle applied on single entities, the three alternatives use a more economical approach and last but not least these three alternatives 'wanted' to be perceived as simple, leading to a stabilisation of the tax system and preferably end in an implementation which is more tax certain. There are also main differences. One can be found in the user participation model making specific reference to digital companies as such, while the marketing intangible proposal should also be applicable in many situations to non-digital companies. Also from the perspective of allocation of taxing rights, the nature differs principally. Where the marketing intangibles and user participation proposals create a system where a portion of the non-routine profit is reallocated to the user/market jurisdiction, the significant economic presence model departs from the perspective of reallocating all (routine and non-routine) profits to the countries

The Secretariat of the OECD has sought to develop a possible new approach based on the commonalities between the three proposals, taking account of the ultimate aim of these proposals, the views expressed during consultations, as well as the need to deliver a solution that is as simple as possible.

The OECD defines the following key features which are relevant for determining whether the new approach will be successful:

- Scope. The approach covers highly digital business models but goes wider – broadly focusing on consumer-facing businesses with further work to be carried out on scope and carve-outs. Extractive industries are assumed to be out of the scope.[47] Apparently the OECD came up with an approach which is applicable on almost all business but extractive industries. In those kind of solutions a problem which could arise is how extractive industries is being defined.[48] Suppose an extracting industry company also has an entity with a treasury function that provides intragroup loans. This is a sort of function which is supportive but still essential for the company. What would that mean? Is the whole company excluded or only that part which focuses directly on extractive activities. Also unclear is the question what the words 'broadly

47 I would be quite interested if anybody can explain to me why we have to exclude extracting industries if the system focuses on digital business models and consumer facing industries.

48 See footnote 46.

focusing on consumer-facing businesses' means. Does the OECD wants to exclude all b2b situations?[49]

- New Nexus. For businesses within the scope, it creates a new nexus which is not dependent on physical presence but largely based on sales. The new nexus could have thresholds including country specific sales thresholds calibrated to ensure that jurisdictions with smaller economies can also benefit from the new system. It would be designed as a new self-standing treaty provision. In principle, this new nexus approach actually adds to article 5 of the OECD MTC another paragraph for recognising a permanent establishment.[50] Two questions can be raised here. The first one is how this is going to work with country specific sales thresholds? So will we get a different threshold under de country A/country B treaty for country A then for country B?[51] Will this create any specific issues under EU-law?[52] And, how simple this all seems to be, countries will have to change their domestic laws in order to make this workable which can also take many years. I assume the OECD wants to use the Multilateral Instrument as an instrument to make this process more effective.[53][54]
- New Profit Allocation. The new rules will go beyond the Arm's Length Principle. It creates a new profit allocation rule applicable to taxpayers within the scope, and irrespective of whether they have an in-country marketing or distribution presence (permanent establishment or separate subsidiary) or sell via unrelated distributors. At the same time, the approach largely retains the current transfer pricing rules based on the arm's length principle but complements them with formula based solutions in areas where tensions in the current system are the highest.
- Increased Tax Certainty delivered via a Three Tier Mechanism. The new approach is intended to increase tax certainty for taxpayers and tax administrations and consists of a three tier profit allocation mechanism, as follows:

49 As a suggestion OECD refers to the € 750m threshold for CbyCR as a possible threshold. See par. 20.

50 See par.5 of this contribution. However for clarity reasons OECD wants to come up with a new article, probably art.5a.

51 It could be possible to refer in the treaty to the country specific threshold and thereby making it possible that the effects will be different in country A compared to country B.

52 Under CCCTB there is one market. Here there is not. Discussions can arise as to whether a different treatment could in fringe EU-law.

53 https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm.

54 In the meanwhile (February 2020) it is clear that there will be a second Multilateral Instrument intended to facilitate a fast implementation of the new plans whichever it will be.

– Amount A – a share of deemed residual profit allocated to market jurisdictions using a formulaic approach, i.e. the new taxing right. Apparently, the formula delivers percentages which will be used to reallocate this deemed residual profit. Profit should be understood in its algebraic meaning which therefore includes also losses. Point of discussion is going to be how countries like the United States or my own country will look at this proposal, since intellectual property is one of the main value drivers. Will IP be compensated for its value contribution before the residual profit is being reallocated? Or does OECD suggest that the IP company just gets its part based on the formula?[55] If the latter is the case, the chances of becoming successful will be limited.

– Amount B – a fixed remuneration for baseline marketing and distribution functions that take place in the market jurisdiction. It envisages creating a fixed percentage return that would be allocated to 'routine' functions like amongst others marketing and distribution. This would lead to a simplified and more standardised distribution return to market countries. Although it sounds quite simple, I foresee a lot of discussions.[56] Distribution can be perceived as a routine function for a company like Mercedes but not for a company like Zalando or Alibaba where distribution is one of the main business drivers.

– Amount C – binding and effective dispute prevention and resolution mechanisms relating to all elements of the proposal, including any additional profit where in-country functions exceed the baseline activity compensated under Amount B. The last part of this sentence seems to refer to situation as mentioned under Amount B. So if Alibaba has a warehouse in country T, should this create a taxable basis which is larger than just a percentage on its routine activities whatever they will be? We don't find the answers yet.

Also typical is that this second sentence is included under Amount C and not under Amount B since the key element of Amount C is the binding and effective dispute prevention. Valuing this, I do agree with OECD that this whole proposal is worthless without a real mandatory and effective dispute resolution. Still, by writing this I do not see this 'Amount C' happening. Under BEPS Action 14 we have seen many states

55 OECD just mentions at par.17 that: "While there seems to be adherence among Inclusive Framework members to the principle that routine transactions can normally be priced at arm's length, there are increasing doubts that the arm's length principle can be relied on to give an appropriate result in all cases (such as, for example, cases involving non-routine profits from intangibles)." This just illustrates that ALP and IP will not go together anymore but leaves the question unanswered whether the new system will take the value creating activities of R&D companies into account.

56 The program is quite ambitious and should be finished before the end of 2020.

ready to participate in a better system of dispute solution but unfortunately even more states refused to go for the full solution. And here, there is no absolute guarantee that disputes will always be solved in such a way that never double taxation will exist. Therefore, a clear Achilles heel has been defined.

6.3. Specific comments

6.3.1. Introduction

Below I will discuss a few elements from the new plans which I believe will create a lot of uncertainty in the market. I will focus on scoping, profit allocation and dispute resolution. I also defined an alternative system which I believe would be better suitable for allocating the profit.

6.3.2. Scoping

The new system is intended to be applied on companies with highly digital business models and companies with consumer-facing businesses. This will certainly enable countries, which under the current rules cannot tax the profit being generated within their borders, to effectively apply these new rules and tax that profit. As a consequence, we see two 'international tax alternatives', nr. 1 is the existing system which will be applied on all companies which do not fall under the scope of the new system, and nr. 2 is the new system which focuses on consumer facing businesses. However, the demarcation between both systems is vague. Par.2.2, 20 from OECD's consultation document states:

> "*This supports the idea that the proposed "Unified Approach" should be focused on large consumer-facing businesses, broadly defined, e.g. businesses that generate revenue from supplying consumer products or providing digital services that have a consumer facing element. It would also suggest that some sectors (for example, extractive industries and commodities) would be carved-out*."

Since to my opinion extractive industries are per definition b2b and not b2c I am surprised that this category is specifically mentioned as to be carved out.[57] Because what does this mean? In a narrow interpretation it can be read that within b2b extracting industries is the only industry carved out and as a consequence others b2b industries are not. I don't believe this is in line with the intention from previous reports.[58]

57 Possibly the example is intended to clarify that profits from natural resources should only be taxed in the state where these resources have been extracted. However, this remains unclear.

58 With probably the exception of the 'marketing intangible' proposal from the previous OECD approach.

However, in a broader interpretation the words "for example, extractive industries and commodities" just give an example. But this broader interpretation seems to be illogical, based on the way the cited paragraph has been build up. The paragraph describes that the new approach should be focused on large consumer-facing businesses whereby *some* sectors are being carved out. The next paragraph continues on this system:

> "*Further discussion should take place to articulate and clarify this scope, including consideration of how a consumer-facing business might be defined and how the concepts of consumer products or consumer sales would deal with the supply of goods and services through intermediaries, the supply of component products and the use of franchise arrangements. Further discussion should also take place to consider whether other sectors (e.g. financial services) should also be carved out, taking into account the tax policy rationale as well as other practicalities. Such discussion should also include consideration of size limitations, such as, for example, the €750 million revenue threshold used for country-by-country reporting requirements*."

This paragraph deals with the same questions but puts a little more detail in the description of consumer products and consumer sales. Here financial services are mentioned as an exception. If this is about consumer facing banks, I can understand this. But further it remains vague what the intention really is. The following paragraphs do not really add a more clear vision on the scoping to this discussion:

> "*Par.2.3 ; 22 In an increasingly digitalised economy, and perhaps beyond today's business models, it seems likely that large businesses will conduct more and more consumer-facing and/or user-facing activities from a remote location, with no or minimal physical presence in the market. The new nexus rule would address this issue by being applicable in all cases where a business has a sustained and significant involvement in the economy of a market jurisdiction, such as through consumer interaction and engagement, irrespective of its level of physical presence in that jurisdiction.*
>
> *23. The intention is that a revenue threshold would not only create nexus for business models involving remote selling to consumers, but would also apply to groups that sell in a market through a distributor (whether a related or non-related local entity). This would be important to ensure neutrality between different business models, and capture all forms of remote involvement in the economy of a market jurisdiction*."

Specifically the sentence '*The new nexus rule would address this issue by being applicable in all cases where a business has a sustained and significant involvement in the economy of a market jurisdiction, such as through consumer interaction and engagement, irrespective of its level of physical presence in that jurisdiction*' creates confusion. However what this sentence says is nothing more than that the proposal will be focusing on taxing consumer-facing businesses without minding the business models within which the company operates.

Unfortunately, by trying to create clarity the OECD actually created confusion. I just do not read a clear view on whether b2b companies/business models are excluded here. Of course I can see the possibility that a b2b enterprise sells spare parts around the globe via an internet site and that this would lead to taxable revenues in the buyer state. But a more clear guidance would have really helped a lot. And the current vagueness will increase the risk of controversy.

I have recommend to OECD in my comments on the consultation paper that there is more than a reasonable doubt that the scoping is clear. I recommended that the final proposal would define which companies will have to apply these new rules. To my opinion the only way that clarity can be achieved is that companies running a b2b enterprise will explicitly be excluded from applying these new rules. The only exception is the part of business models that makes sales in other states via the internet. Companies with combined business models will only have to apply the new rules with respect to their consumer-facing and/or user-facing activity.

6.3.3. Profit Allocation

The OECD's Secretariat's proposal outlines a new system for allocating taxing rights among countries, provides some new elements like (country specific) thresholds and defines which companies might be impacted by the proposal. The proposal contains three separate categories of taxable profits that is intended to realise a baseline for taxing companies by countries under the Unified Approach.
Those categories are as follows:

- Amount A: the deemed residual (non-routine) profit allocated to market jurisdictions
- Amount B: a fixed return for marketing and distribution activities in market jurisdictions
- Amount C: contains two elements. The first one defines an additional taxable amount beyond Amount B that may be taxed in a specific market jurisdiction, the second one describes the need for binding and effective dispute prevention and resolution necessary to minimize double taxation possible under the new three tier system.

It is without doubt that this combination of amounts will reallocate taxing rights in situations where the Unified Approach focuses on. Besides the scoping of these new rules as discussed above, the new system will lead to various new perspectives and to a tremendous change about where multinational businesses pay their taxes. However, the new system creates a lot of new issues. Apparently, the need to allocate more to states where the Unified Approach is creating new taxing rights, is so high and the original three alternatives were so difficult to implement that the new system feels like a very complicated compromise. From a theoretical perspective it should clearly work. In practice, I expect many new issues.

In the new system there are in principle two possibilities. The first one is the situation where a company runs a business from one state that has a consumer-facing activity which leads to sales in other countries and the second one the situation where a company runs that same business but already has a taxable nexus under the current rules outside the home state. In principle if a company has no subsidiary or a permanent establishment in another state, only Amount A will be applied. If a company also has activities in another state which are under the current rules already taxable, then Amount B and possibly Amount C will be taken into account. Whether Amount C is applicable depends on the tax authority in that other country where it is not far from imagination that this country will have the perception that the fixed margin on marketing and distribution activities is not a sufficient reward and therefore believes that an additional Amount C should be taxed.

Here one of the main dispute issues kicks in. There is a reasonable possibility that the combination of Amounts B and C would overlap with the share of non-routine profits under Amount A. Simply because in the new system Amount B is based on a fixed margin and therefore any deviation which leads to more taxation in that state, will erode Amount A. It is clear that the state where the seller company is a resident is not going to give in that easy and the company is going to face double taxation. The reason for creating an Amount C by the OECD is that the OECD acknowledges that under the current rules already many disputes exist and the OECD seems to believe that the acceptance of the Unified Approach will make it more easy for states to support this. But how to deal with double taxation? The solution offered by OECD for those kind of situations is rather weak. Any dispute between the market jurisdiction and the taxpayer over any element of the proposal should be subject to legally binding and effective dispute prevention and resolution mechanisms. MAP's but also ICAP would play an important role here. Disputes will amongst others include those cases where there are more functions in the market jurisdiction than have been accounted for by reference to the local entity's assumed baseline activity. From a theoretical perspective, MAP's and Arbitration sounds indeed like a solution, but for a multinationals this means years in a procedure for a mutual agreement solution or an arbitration solution and therefore years of uncertainty. See further paragraph 6.3.4 below.

The OECD provides the following example for the new profit attribution approach. Group X is an MNE group that provides streaming services. It has no other business lines. The group is highly profitable, earning non-routine profits, significantly above both the market average and those of its competitors. P Co (resident in Country 1) is the parent company of Group X. P Co owns all the intangible assets exploited in the group's streaming services business. Hence, P Co is entitled to all the non-routine profit earned by Group X. Q Co, a subsidiary of P Co, resident in Country 2, is responsible for marketing and distributing Group X's streaming services. Q Co sells streaming services directly to customers in Country 2. Q Co has also recently started selling streaming services remotely to customers in Country 3, where it does not have any form of taxable presence under current rules.

Regarding Country 2 Group X has a taxable presence in the form of Q Co. Under the new economic nexus concept, Country 2 must determine whether Group X has a new non-physical taxable presence. If Q Co generates sufficient sales in Country 2 to meet the revenue threshold, then Country 2 has a new right to tax a portion of the deemed non-routine profits of Group X. Country 2 may tax that income directly from the entity that is treated as owning the deemed non-routine profit (in this example, P Co), with the possibility of Q Co held jointly liable for the tax due to facilitate administration.

The way OECD structured the new system, is still to a large extent a bilateral system. And that might as well be a very important weakness in the system. I do believe that an alternative like a multilateral approach as described below would be a better way forward. The reason for choosing a bilateral (or mainly bilateral) approach by OECD is a simple one: it is much easier for the countries to deal with. The taxing state acts autonomously and the seller state provides for double tax relief or both states go into one of the existing, but far from perfect, dispute resolution possibilities. Issues which will arise have to deal with the valuation of routine activities as being done under the current system (relevant for Amount A) and the situation where a company has a taxable presence under existing rules in a country and that country is allowed to tax a fixed return for baseline marketing and distribution activities but believes it is entitled to more. Country 1 must grant relief from double taxation via P Co claiming a foreign tax credit or an exemption. But country 1 could be of the opinion that the fixed return for baseline marketing is sufficient and will not actively relief double taxation.

In this example Q Co is a relevant taxpayer for the new fixed return for baseline marketing and distribution activities. Traditional transfer pricing adjustments are necessary to cover transactions between P Co and Q Co, which without them would lead to double taxation. Here we see the old system back however in a modified way by adding fixed margins to it. Finally, if Country 2 allocates additional profits under the arm's length principle to Q Co because its activities go beyond the baseline activity as intended for the fixed return arrangement for marketing and distribution activities, then Country 2 should be subject to robust measures to resolve disputes over double taxation with Country 1. However, the solutions offered by OECD are the standard ones which all lack the essential part, namely robustness.

One last remark is the possibility for states to levy a withholding tax on payments to the seller company as an alternative for the situation that state misses out on its right to tax profits which relate to domestic sales. In order to do so, I assume blockchain technology will have to play an important role. Still, a unilateral action from one state to levy a withholding tax on these kind of payments should to my opinion be rejected. This system will suit that state since it will capture the profits it believes it is entitled to, but creates difficult problems for the company. The parent company is still paying taxes on the same profits and it is not clear whether the state where that company's headquarter is registered, will credit the underlying withholding tax. It depends on the applicable treaty but also on the title under which this withholding tax is levied. In these kind of situations the company which is acting in good faith will very often be confronted with double taxation. Reallocation profit is a good way forward. But levying a withholding tax should be rejected.

An alternative

First of all, multinationals have to operate in a world which is experiencing increased complexity. The current Unified Approach seems not to be the most effective solution for companies. A better Unified Approach is to my opinion one which is based on a multilateral solution. Only a multilateral solution in combination with a multilateral dispute resolution does justice to the necessity for multinationals, which do want to pay taxes in all states where they are legitimately due, to be protected against double taxation caused by two states with a different view to allocation mechanisms or states which go on their own and tax whatever they can, for example based on scoping.

Secondly, the combination of a sales based system would to my opinion best served with an alternative which relates to existing obligations like the obligations related to global VAT reporting. Based on this system, states will only be able to tax the multinational in its country provided that it makes sales according to the criteria of this alternative Unified Approach. If a company would execute only marketing in one country without making any sales in that country, no profit will be allocated to it. The systems contains actually three steps:

Step 1.

Determine the global registered revenues according to VAT rules. Only if this amount exceeds € 750 mln, the new system will be applicable.

Not all countries have a VAT system in place but probably they have a comparable system.[59] I do acknowledge that the OECD will have to set some additional steps in order to define global rules which can be used for this system.

Step 2.

Define a system which also includes country specific thresholds. Select those countries where the specific threshold has not been exceeded and add up these country related revenues to the revenues in the state where the multinational is making the sales. Only sales in states which exceed the threshold play a role in profit allocation. But before this allocation, specific value drivers have to be defined in order to justify

59 Interesting follow-up research should be done by a combined international tax/VAT specialised group of people.

taxation by those states where value drivers have been created like intellectual property rights and/or algorithms etc. Here old fashioned TP steps back in. 'D(A)EMPE(P)' conform allocation is of course possible.[60] In order to do so, the value of specific value drivers should be determined. Regular valuation techniques can be used. This value has to be allocated to the countries which participate in the value creation (DEMPE(P)).

Step 3.

From the global profit which has to be apportioned, first the amount for the specific value drivers has to be deducted. Then the remaining profit will be allocated to all states where sales are being made and these sales exceed the country specific threshold. The state from which the sales are being made will add the amount for the specific value drivers.[61]

This alternative is beneficial to companies and countries. It makes tax structuring hardly possible anymore since profit allocation follows sales. Old-fashioned transfer pricing elements are now limited to one single step, namely the valuation of the value creators. This makes the whole profit allocation system much more transparent without offering the possibility for states to create 'reasons' to still tax profit which these states are not entitled to.

This is why I have recommended to OECD to consider changing the Unified Approach to the above-explained alternative.

6.3.4. Dispute Resolution

If the OECD proposal will be accepted, multinationals with a certain scale will be taxed either under the current international tax system or the new system as proposed in OECD's report. Sometimes multinationals will be taxed partly under the old rules and partly under the new ones. As a consequence, new issues will arise. First of all, it will make a difference whether a company will be (fully) taxed under the new rules or under the old rules. Since the approach under the new rules is still uncertain and at the current stage offers states many possibilities to optimize tax revenues, it is not a matter of just reallocating taxing rights but also of how the traditional ALP system will interact with the Unified Approach. Where under ALP the scoping is reasonably clear, this cannot be said for the Unified Approach. This is the first source of possible controversy. Companies can experience being taxed in their headquarter country by the traditional system and in the country in which it generates business via the Unified Approach. The second source of controversy faces the situation where both states

60 The core abbreviation is DEMPE which stands for Development Enhancement Maintenance Protection and Exploitation. Some states use the A from acquisition and/or the P for promotion. Every letter creates a focus for profit allocation.

61 From my perspective the world will not agree on a new system if the value creation by companies is not taken into account in the profit allocation.

apply the Unified Approach but where the approach of allocation via one of the amounts (A, B or C) is different.

For that reason it has to be absolutely clear under which system a company will be taxed and how. The OECD recognises this and therefore one of the seven questions for public comments deals with this:

> *"7. Amount C/dispute prevention and resolution.*
>
> *In the context of Amount C of the "Unified Approach", what opportunities do existing and possible new approaches to dispute prevention offer to reduce disputes and resolve double taxation? In particular, what are your experiences with existing prevention and resolution mechanisms such as:*
>
> *a. (unilateral or multilateral) APAs;*
>
> *b. ICAP; and*
>
> *c. mandatory binding MAP arbitration?"*

For me this suggestion is just not going far enough. More should be done to guarantee that no double taxation at all is due. Juridical double taxation is difficult to catch but if the OESO wants a global solution and comes up with new detailed rules, it is not more than reasonable that this issue will be solved. First of all it has to be clear that multinationals will expect from OECD that a new system will not be created without the full certainty that operating in an international environment will lead to a zero sum game. This means that the new Unified Approach can only be accepted if it will be guaranteed that no (economical) double taxation will arise as a consequence of these new rules. That is why I believe that these new rules which will create various new disputes need to be supplemented with multilateral dispute resolution. Countries have demanded from OECD a solution which works for all countries around the globe. But companies are a relevant stakeholder here too and they demand a clear zero sum game. And to my opinion any dispute resolution should depart from the multilateral perspective from the company.[62]

APA's

The OECD mentions three systems to deal with controversy. System One deals with APA's. I do not believe APA's can solve all double tax issues which will be created by the introduction of the Unified Approach. I will differentiate between a unilateral APA, a BAPA and a MAPA. A unilateral APA is not going to solve the problem of double taxation for a multinational, simply because it only has effect on the pricing in the country where the company is headquartered. A bilateral APA seem to promise more security since in relation to two states there is certainty that no double taxation can arise (zero sum game). But in a situation where for example the company is active

62 See below, however global companies have to deal with multiple cases if there is only a bilateral solution available. Therefore a multilateral is the best solution.

in more than two states any third state could demand that the company shares the bilateral APA with that third state (or via exchange of rulings) whereby that third state will possibly find arguments to increase the tax base in that country if the allocation to the second state subsidiary under the BAPA is higher than as reported in the tax return and transfer pricing documentation with respect to the third state. Third states often argue that the fact that the activities in country two and three are comparable and thus the allocable margin should be equal. This thought will give that third country the right to increase the tax base. Only if the state of the headquarter is willing to give in, double taxation can be avoided. In practice, this is not always the case.

That multilateral APA's could do the job, is doubtful. First of all, there is not very much experience with MAPA's, let alone that, to the extent there is experience with MAPA's, this is most of the times limited to three to five countries. A multinational which works globally and is perceived to be consumer-facing in for example 40 countries, would have to go in a long lasting project to first convince its nexus country to start a MAPA procedure and then still has to wait whether the other 39 states are willing to participate in this or not, and, last but not least, to achieve a result which excludes any risk of double taxation for the company in those 40 states. I don't expect this is going to be a feasible solution.

ICAP

The international Compliance Assurance Programme (ICAP) is a voluntary programme for, as the OECD calls it, multilateral co-operative risk assessment and assurance process. It is designed to be an efficient, effective and co-ordinated approach to provide multinational groups willing to engage actively, openly and in a fully transparent manner with increased tax certainty with respect to certain of their activities and transactions. Relevant is another quote from OECD regarding this programme: '*ICAP does not provide an MNE with legal certainty as may be achieved, for example, through an advanced pricing agreement'*.

This background makes ICAP a system comparable to a 'horizontal monitoring' system. ICAP was launched in Washington D.C. in January 2018. It brought together eight tax administrations, from Australia, Canada, Italy, Japan, the Netherlands, Spain, the United Kingdom and the United States. ICAP 2.0 was announced at the OECD Forum on Tax Administration Plenary held in Santiago, Chile on 26-28 March 2019. New participating states are: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Luxembourg, Norway and Poland.

Although the ICAP system is intended to create a better alternative for multinationals to prevent double taxation with respect to (mainly but not solely) permanent establishments and transfer pricing, the main intention is horizontal monitoring. Still, the new international tax rules on profit allocation, which offer an alternative beyond the current transfer pricing systems, could be covered by ICAP.

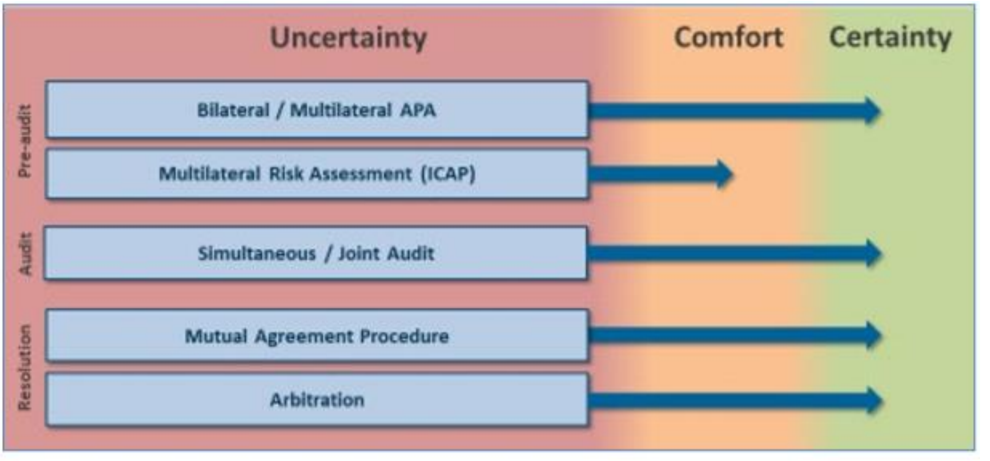
Since ICAP is an international horizontal monitoring system, it does not absolutely guarantee the zero sum game. This becomes clear from the ICAP 2019 Pilot Handbook, which describes more effective dispute resolution as follows (page 5):

> "*More efficient and effective mutual agreement procedures (MAP) are being implemented as a result of BEPS Action 14. A multilateral risk assessment and assurance programme can support these dispute resolution initiatives by preventing unnecessary disputes from arising and limiting MAP inventory growth. One of the most effective ways to manage the risk of disputes between tax administrations is through mechanisms to prevent these disputes from arising*."

ICAP connects here with BEPS Action 14 but also mentions that ICAP is intended to manage the disputes between tax administrations through mechanisms that prevent these disputes from arising. So, instead of being confronted with a tax audit years after the annual accountants have been formatted, ICAP will be started in a very early stage and therefore a lot of time is being saved. The issue however with ICAP is that the OECD is not convinced that ICAP could be a better solution or a solution that provides a company with more certainty. This is mainly because ICAP is intended to support states to better and faster monitor tax risks. Below the several solutions the OECD offers to states:

> "*ICAP is one of a suite of tools available to tax administrations to provide greater certainty to MNEs with respect to their tax risk. These include:*
>
> - *tools to provide upfront legal certainty for specific transactions or arrangements, including APAs*
> - *tools to improve effective tax risk assessment, including standardised risk assessment documentation under BEPS Action 13*
> - *tools to improve effective tax audit, including global awareness training to improve domestic processes for the audit of international tax risks and programmes for the simultaneous or joint audit of MNEs*
> - *tools to improve effective dispute resolution, including improvements to MAP under BEPS Action 14 and mandatory binding arbitration such as under the multilateral convention to implement tax treaty related measures to prevent BEPS (the MLI).*"

In the figure below, the OECD positions ICAP with respect to the perspective of comfort and certainty for companies in relation to other systems like e.g. APA and MAP. Where practice clearly experiences issues with BAPA's and MAPA's as mentioned in the previous paragraph, the OECD believes that these solutions provide more certainty. As mentioned previously, I believe this is only true in the direct relation between the states involved. Due to exchange of information of rulings, the indirect consequences are more uncertain. As described the worst BAPA will be leading for the others and a MAPA with many countries seems unrealistic yet. Below, the results from the OECD's overview (Pilot Handbook page 8):



It is interesting to see that ICAP offers the lowest certainty from all alternatives to deal with controversy issues. One of the reasons is that most of the alternatives cover in practice bilateral situations, where ICAP focuses on multilateral ones.

Still, I believe that the Inclusive Framework members should consider ICAP as the main instrument for providing certainty to multinationals. ICAP is an essential step forward to have the Unified Approach being accepted. Still, some steps have to be set. These are all due to current issues with ICAP. First of all, at this moment ICAP seem to be manageable with a maximum of 20 states.[63] Will the process also be manageable with 50 or 100 states? The answer is probably that it could work provided that this system will be modified. Essential part of this is that the OECD will agree with the participating states that whenever they want to apply the Unified Approach, they automatically participate in a system where the decision on a controversy dealing with the Unified Approach will be taken by an independent organ, which tests the application of the Unified Approach and provides a binding solution. If ICAP really has to play a role, this is the only way forward.

Secondly, from the experiences of ICAP 1.0 some lessons can be learned. And where OECD recognises that ICAP does not provide certainty but it does provide comfort, I have a different opinion. From the perspective of the period within which the programme should be finished, ICAP offers clear benefits. But that is not the whole story. Participating multinationals under the first stage of ICAP were obliged to deliver an enormous amount of information and that several times. The OECD recognises this and has promised to limit the scoping by adding a new scoping stage to the ICAP risk assessment and assurance process, which takes place to determine

63 If manageable at all. Experiences from companies I have spoken to with ICAP are far from positive.

whether any covered transactions will be excluded from a covered tax administration's ICAP risk assessment, if appropriate. This ensures that an MNE will only be required to provide documentation relevant to transactions that are within the scope of its risk assessment, in the above situation the execution of the Unified Approach.

I am not convinced that limiting the scope will solve the problem, since within the scope (Unified Approach) still many requests for information will be sent out to the company. And the fact that ICAP went from eight to twenty states will possibly also play a role. With twenty states it is going to be challenging, but with fifty states or more it seem to be impossible that the company will be able to deliver again and again information to all states. This last problem can only be solved if an organ will be appointed that not just delivers a binding solution but will also be in charge exclusively with respect to the flow of information.

If executed in this modified way, I see ICAP becoming very helpful in guaranteeing that no double taxation will arise to the company that will be taxed according to the new Unified Approach. However, countries should be willing to give up sovereignty with respect to this subject and allow a new to be appointed organ to decide on the profit allocation but also on the scoping. Such an organ could be called a 'Dispute Resolution Committee'.

For companies it is irrelevant on how this committee will be staffed provided that the committee makes sure that there will be a uniform process with respect to the way information should be provided by the company in an efficient way and secondly that the suggested solution by the committee will be fully binding.

Arbitration

Will arbitration be the solution for disputes with respect to scoping or profit allocation? First of all, there are several ways in which an arbitration process can be taken place. Without intending to mention all the following are best known.

1. Baseball arbitration

   In this system each party shall submit to the arbitrator and exchange with each other in advance of the hearing their last best offer and demand. The arbitrator shall be limited to awarding only one of the two figures submitted. This is the preferred system under the MLI.

2. Night baseball arbitration

   This is a variation on the previous system. The difference is the parties exchange their own determination of the value of the case but those figures will not be disclosed to the arbitrator. The arbitrator carries on with the case and determines the value in his or her award after which the parties agree to be bound by the figure that is closest to the arbitral award.

3. Independent opinion model

Under this model, the arbitration panel is composed of three independent individual members. One member is to be appointed by each competent authority and those two members must then appoint a third member who is not a national or resident of either country to serve as Chair of the arbitration panel. This is the system which will be applied under the MLI if states have made a reservation on baseball arbitration.

Will these systems provide certainty to companies under the Unified Approach? I expect that none of these systems will be workable if an enterprise has to pay taxes in many states, at least not in the current stage, since the system seems to focus mainly on bilateral issues. It is not that there are no experiences with multinational arbitration. More specifically, within the European Union the Arbitration Convention, which has been agreed in 1990 was, until recently, still being applied. It worked as follows. If an adjustment is expected which results in double taxation, a multinational may present its case to the competent authority in the Member State where it is established. The enterprise should file the request within three years from the date of the first tax assessment that resulted in double taxation. The enterprise and the competent authority must inform the other Member States involved that a controversy is due. The Member States involved will have two years to reach an agreement which eliminates double taxation. If they don't succeed they must set up and advisory commission that will deliver an opinion within a six month period. Afterwards the Member States still have six months to come to a mutual decision which differs from the commission opinions as long as it eliminates double taxation. However if they fail to come to an agreement, they are obliged to act in accordance with the opinion of the commission.

To a certain extent, this system has worked well but in most cases, only a limited number of countries was involved. In the meanwhile, the system has been replaced by a Council Directive on Tax Dispute Resolution Mechanisms in the European Union.[64] This directive contains principles, which are known also from modern tax conventions and the MLI. This directive is also applicable for multilateral cases dealing with double taxation. The remaining question is whether these alternatives will lead to a guaranteed zero sum for multinationals whenever a discussion arises with respect to the scoping or the profit allocation under the Unified Approach. Both the original arbitration convention as the new directive have the 'advisory committee' installed as a way forward to come to a solution. But under the directive the Advisory Committee is not a mandatory step. Further on the directive also created an Alternative Dispute Resolution Commission. The main benefit from the EU Directive on Tax Dispute Resolution Mechanisms is that in the end there will be a binding solution. But also this directive is not perfect since it allows the states to reject the application in case of

64 Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union *OJ L 265, 14.10.2017, p. 1–14.* See https://eur-lex.europa.eu/eli/dir/2017/1852/oj.

a conflict on qualifications issues. Still the principles as being developed by the EU could play a role in any multilateral solution for OECD since there are valuable experiences.

Which solution to prefer?

I prefer the ICAP solution with a modification that adds to the programme a 'Dispute Resolution Commission' which comes up with a binding solution for all states. Why ICAP? ICAP plays a role before an issue could possibly arise and will deliver therefore more certainty to states and also to companies if the modified system will be chosen. Suppose the OECD decides on a global threshold of € 750 million for applying the Unified Approach, companies which currently fall under CbyCR will have to use the modified ICAP to prevent any disputes. This will create a challenge for the Inclusive Framework since any Dispute Resolution Commission needs to be staffed and since this Commission is independent, states will lose their sovereignty. But, where countries want their fair share, companies should be entitled to a fair process and for this it is necessary that binding resolutions are the rule.

A second solution could be arbitration as suggested under the MLI, irrespective whether baseball arbitration or the independent opinion model, provided that the solution is fully binding. Still, since arbitration takes place after an issue arises and since the process will also takes up to a couple of years, the ICAP seem to be the most effective way forward. For countries and companies. Arbitration seems to be just the second best solution and therefore I would recommend the modified ICAP.

6.4. Trouble in paradise?

The longer the consultation process has ended the more clear it becomes that Pillar One is facing enormous problems. Where India in first instance supported this development[65], in second instance the country seems to go in a different direction. The Indian equalisation tax is set at 7% and its application is not too complicated. Rumours go that therefore India will continue to apply this alternative. In another part of the world, African states have suggested they are not willing to follow Pillar One since the arbitration system seem to infringe on their rights to be sovereign with respect to taxation. Several other issues have been mentioned in amongst others a recent ICRICT report.[66]

65 https://www.bloombergquint.com/opinion/taxing-the-digital-economy-white-smoke-emerges-from-the-oecd

66 Report from November 26, 2019. https://www.icrict.com/icrict-in-thenews/2019/11/27/paris-consultation-reveals-little-unity-on-oecds-unified-approach-for-taxing-multinational-groups

If those comments were not already very difficult for OECD, the latest response from the US will have struck the OECD as if it was a lightning.[67] Treasury Secretary Steven Mnuchin warned the OESO of the consequences new international taxes could have on American business and voiced opposition to the recent introduction of digital services taxes. In a letter to the OECD, Mnuchin said the US objects to digital services taxes because they "*have a discriminatory impact on U.S.-based businesses*."

He also said: "*We have serious concerns regarding potential mandatory departures from arm's-length transfer pricing and taxable nexus standards — longstanding pillars of the international tax system upon which the U.S. taxpayers rely*".[68]

The optimistic views many had on all the recent work from the OECD seem to change in a more negative attitude where every day relevant states seem to divert from the OECD's views. For the European Union this will have as a consequence that more and more states will go on their own and will introduce an equalisation levy like France does. And that again creates new discussions with the United States and new barriers for European companies to sell within the United States.[69] Or in other words… OECD's BEPS plans have united the world to a certain extent, but Pillar One seems to be breaking this new 'cohesion' into pieces again. More and more states go on their own and companies will suffer from global uncertainty, higher compliance costs, many new controversies and the impossibility to solve part of their issues. Apparently, the OECD under pressure of Germany and France just wanted too much too fast and as a consequence all these good intentions have derailed before they reached the expected destination. This normally happens this way. A gentleman always walks, never runs….

7. The show ain't over until it is over

7.1. Introduction

On January 31, 2020, the OECD reported what they call significant steps in advancing Pillar One. At its January 29 and 30 meeting, the OECD Inclusive Framework endorsed the Pillar One approach and approved a way forward for negotiating the final Pillar One principles by the end of 2020.

Accompanying the IF's Statement reporting the outcome of the meeting, the OECD released relevant guidance in connection with key issues associated with the

67 https://www.cnbc.com/2019/12/04/treasurys-mnuchin-warns-of-global-taxes-opposes-new-digital-duties.html

68 See previous footnote.

69 See amongst others: https://foreignpolicy.com/2019/12/03/nato-trump-europe-trade-war-digital-tax-google/

implementation of Pillar One[70]. A revised Programme of Work was also issued outlining the remaining work to be done.

At the same time, the OECD noted continued progress on Pillar Two, the global base erosion (also known as “GloBE”) project. Also this project should deliver final principles before the year end.

The Inclusive Framework has reaffirmed its commitment to reach comprehensive consensus based solutions to the taxation of the digital economy and countering global base erosion. For this reason, the Inclusive Framework is working under a very tight timetable with all kind of updates scheduled for March and early-July 2020.

One of these challenges is obtaining consensus among 137 countries. Still the Inclusive Framework has already shown that it seems to be achievable to move the project forward. If consensus will be reached, Pillar One will present the world with a totally new approach of international taxation.

7.2. How did OECD respond to all the received comments?

The OECD already suggested that Pillar One should only be applied on companies with a certain scale and then it seem to be logical to use the well know country-by-country gross revenue threshold of € 750 million. If a multinational has more gross revenues than € 750 million, then the next question is whether the multinational has sustained and significant involvement during a certain testing period (for example three years). Substantial involvement should be a function of the size of the market in which the multinational operates. The Inclusive Framework did not define a minimum but from previous discussions, it is to be expected that there will be country specific thresholds. Probably also an absolute minimum could be part of the deal.

Last but not least, the Inclusive Framework also suggested a *de minimis* threshold for companies with gross revenues exceeding € 750 million but with only minimal foreign income. For me it is questionable whether this is needed. The country specific thresholds already prevent companies with smaller foreign sales from being taxed under the new rules.

The OECD did shine new light on what kind of businesses are in the scope of Pillar One. The basic premise did not change. Pillar One is intended to focus on consumer facing businesses that transact on a digital basis. In the original Public Consultation, Pillar One was focused on consumer-facing businesses. The OECD received numerous comments on the scoping since this was far from clear. The new Inclusive Framework Statement provides further guidance on in-scope activities by identifying two broad categories of businesses that will be covered.

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70 https://www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf

The first category is known as "automated digital services" ("ADS") which intends to capture those companies which provide digital services to large populations of consumers in multiple jurisdictions. Examples from the Statement include:

- Online search engines
- Social media platforms
- Intermediation platforms
- Digital content streaming
- Online gaming
- Online advertising
- Cloud Computing

To a certain extent these examples do not come as a surprise although some commentators on social media raised the question whether cloud computing is not a mere B2B operation. Still the Inclusive Framework Statement notes that further work is still required on the definition of automated digital services especially for business models that deal mostly with other businesses. Apparently, the Inclusive Framework does recognise the problems with for example cloud computing.

The second category of in-scope businesses are consumer-facing businesses, namely the generation of revenue from the sale of goods or services directly to consumers. For example, the definition of a consumer-facing business would be expected to bring into scope the following non-exhaustive list of businesses:

- personal computing products (e.g. software, home appliances, mobile phones);
- clothes, toiletries, cosmetics, luxury goods;
- branded foods and refreshments;
- franchise models, such as licensing arrangements involving the restaurant and hotel sector; and
- automobiles.

The Inclusive Framework Statement identified one important exclusion to this category of in-scope business as the consequence of the many received comments. If an MNE is selling "intermediate" products, i.e., products and components that are incorporated into a finished product sold to consumers, then the new nexus approach is not applicable. It is again, as an exception on the rule, applicable where the component itself is branded and commonly purchased by consumers directly.

The Inclusive Framework Statement also identified a number of industries that are expected to be excluded from Pillar One. These include the extractive industry and certain aspects of the financial services sector which were identified in the original Public Consultation. As said above, it remains unclear why the extractive industry is named as an exception since that industry is wholly B2B and hardly any sales will be made digitally.

The Inclusive Framework Statement also identified the shipping and airline businesses as additional industries to be excluded. As the Statement notes, the long-standing internationally accepted approach for the taxation of these industries is to assign exclusive taxing rights over the profits of shipping and airline companies to the residence countries of such companies. This policy is already reflected in nearly all bilateral tax treaties. In response to comments by industry groups, the IF correctly concluded that it would be inappropriate to include these businesses in Pillar One. For me this is a strange consequence. Many airliners sell their tickets via the internet and therefore they operate in an international market. Why would be article 8 of OECD's model tax convention deserve an exception under Pillar One and, to name just one, article 5 not?

Another element of Pillar One where OECD came up with some additional information is what is called the question of segmentation. Many multinationals conduct multiple businesses, some of which may be in-scope for Pillar One and some may not. As a result, segmentation will be essential to ensure that Pillar One only applies to relevant businesses from that multinational. The IF Statement indicates that segmentation will apply and further work is necessary to determine what level of segmentation is practicable and verifiable.

For practice, the main issue is here who decides on that segmentation. A one-stop-shop approach is essential to make sure that no different approaches of segmentation with as a consequence double taxation will arise.

Pillar One's success will be amongst others be dependent on an effective double tax relief. When an Amount A is allocated to a market jurisdiction, that amount is effectively surrendered from one taxing jurisdiction (the "surrender country") to the market country. The Inclusive Framework Statement notes that there are several options to mitigate double taxation including a foreign tax credit, an exemption or a deduction. A deduction can do justice to some forms of double tax relief but is hardly ever a full double tax relief. Either an exemption (preferred by me), or a full tax credit is necessary to deal with this. The Inclusive Framework Statement notes that further work is still required on this point.

As said before, the main Achilles heel of the new system is the acceptance by all states in the Inclusive Framework of a decent (read: mandatory) dispute resolution since Pillar One is intended to reallocate global profit between jurisdictions. Above, I already explained that only a multilateral dispute resolution will do justice and apparently the Inclusive Framework is trying to deal with disputes in a multilateral way. The Inclusive Framework Statement proposes the creation of a new multilateral instrument that would contain all the rules needed to implement Pillar One. This new "Pillar One MLI" would be agreed by all Inclusive Framework members and supersede the relevant provisions of existing bilateral treaties, like amongst others permanent establishment articles. The Inclusive Framework Statement notes that securing agreement on a new Pillar One MLI requires a "strong impetus at the highest political level….". This is even with some understatement since many states are not going to accept these new rules if no mandatory solution for disputes will be available. Although my glass is most of the time half-full, it appears to be half-empty when I consider all the consequences of this new system.

The International Inclusive Framework has recognised the possibility for states of levying new taxes based on the reallocated profit to the states. Specific examples are VAT, customs duties and specific local taxes. Would the Inclusive Framework have chosen my alternative approach, then the main issue (with digital services VAT) would be over. It would have also led to a more integrated way for taxing companies. However, the Inclusive Framework Statement notes that the rules will be designed to avoid such spillover effects.

Last but not least, part of the deal will be that states will not implement any unilateral digital services taxes. I am quite curious since India already recognised that their digital service tax will lead to higher revenues than a Pillar One approach.

7.3. An impasse due to the United States?

On December 3, 2019, US Treasury Secretary Mnuchin sent the previously mentioned letter to the OECD Secretary General supporting the continued work of the OECD to reach a consensus-based solution and urging the suspension of digital services taxes.[71] In that letter, the Secretary noted concerns regarding mandatory departures from the traditional nexus and arm's length standards.

His alternative is one which includes a rather peculiar 'safe harbor'. He suggests that all the concerns could be addressed by letting a multinational elect into Pillar One on a global basis. In his opinion, Pillar One should become an elective alternative for the current system. An electing multinational would benefit from all the global dispute resolution mechanisms, and of course the new Pillar One MLI, in return for agreeing to the application of the new nexus standard and the allocation of income to a market country. But would this mean that he accepts the fact that a non-electing multinational would be taxed under traditional standards and, presumably, continue to be subject to digital services taxes? For me the answer on this question remains unclear. Why would a multinational elect the traditional system knowing that digital service taxes can probably be deducted from their global business income but there will always remain a factor of double taxation?

71 See footnote 64.

Still the Inclusive Framework Statement agreed to consider the US recommendation. It mentions that further work will be needed to address the feasibility of this approach, its revenue and economic impact at the country level as well as the administrative and dispute resolution implications.

For me, this consideration is nothing more than a political statement to keep the US lined up in this whole Pillar One Process since if the US withdraws the world is back in a society with more and more states implementing their own digital services taxes.

8. Conclusion

The Unified Approach was considered to be an interesting next step, however in the current way it is not going to be the solution for the future. A new division of the tax pie over all states is only acceptable if companies get a guarantee that no (economical) double taxation will be due. Reality is that under the Unified Approach this is simply not going to happen.

In the meanwhile, the first countries have already informed the world they are not going to follow the Unified Approach. The digital economy has led to a specific tax issue, namely the difficulties for states to effectively tax the profit generated within their borders. But apparently, the world is far from finding a solution for it. The US alternative approach proves how fragile this approach is.

And with respect to the Arm's Length Principle, I do have to conclude that this old tool has survived many decades and will be in service for many years to help taxing all kind of new business models. From all the recent developments I believe there is no acceptable alternative for all the states, which is necessary, since some of them will lose and some of them will win. Whenever a state loses, the best solution is to reject any change which creates this situation. But by saying so, it becomes actually clear that the new approach for the digital economy has a time line which ends in the end of 2020 and apparently that seems to be the accepted deadline by the Inclusive Framework. I am afraid it is going to be more a death line, i.e. the date that this whole project will be obsolete and the world will go on its own.