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The Absence of a Stable Core in the International Taxation Regime

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In this article, the author sets out his views on the problems arising as a result of the lack of a stable core in the current international tax regime, together with ways in which this absence could be resolved.

1. Introduction

Despite serious attempts over the last decade by the international tax expert community and the increasing participation of emerging economies in the deliberations, finding a stable core for the international taxation regime has proved to be a challenging task. This article notes and analyses selected issues relating to this topic. These issues pertain to a continuing flux in the acceptance of the source principle of taxation over the residence principle despite the OECD's increasing recognition of the former; the OECD's relative ineffectualness in challenging tax havens; various lingering issues in the adequacy of taxing the rapidly emerging and already existing global digital economy, including the OECD's Pillar One[1]and Pillar Two[2]proposals, the UN's proposals and unilateral actions in the form and variants of a levy to equalize its taxation with that of other productive sectors; and the OECD's reticence in taking measures against retrospective enactment of tax law. In light of these shortcomings, the article considers some of the alternatives that have been proposed by international experts in locating the international taxation regime in the UN or even creating an altogether independent global tax authority.

2. Permanent Establishments and Source versus Residence

The changes that have occurred in recent years with the advance and acceleration of digital access during the COVID-19 pandemic and beyond include remote business operations with no local presence while maintaining management functions in more than one jurisdiction. The spread of "home office" work has been significant. Many employees seem to prefer this situation. Some multinational enterprises (MNEs) have cut back on local presence. Given this development, the concept of a permanent establishment (PE) may need to be revisited and redefined. The question arises as to whether such changes should apply exceptionally to certain industries or become the general rule. In turn, this could be perceived as the virtual - rather than the physical - presence of a business in determining source for taxation purposes.

The OECD has essentially endorsed a move from residence taxation to source taxation by way of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project.[3]This action is commendable and it must be pushed to the fore, as it attempts to reassign tax revenue allocation among trading countries in the right direction. In the 1990s, the United States changed its rules and permitted related foreign companies to be "de-linked" from their US parent by way of the "tick the box" rules - a set of loose criteria - resulting in a lack of relationship for tax purposes. That is, if they did not remit profits to the United States, there was no tax to be paid. In other words, tax was "deferred". This change destabilized the parent-PE relationship and contributed to the OECD/G20 BEPS Project.[4]

India and several emerging economies had argued steadfastly well before the OECD/G20 BEPS Project that, justly, tax revenue must accrue in the source jurisdictions where value-added was created in the international supply chain in respect of

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1. OECD, *Secretariat Proposal for a "Unified Approach" Under Pillar One. Public Consultation Document* , 9 Oct.-12 Nov. 2019 (OECD 2019), available at https://www.oecd.org/tax/beps/public-consultationdocument-secretariat-proposal-unified-approach-pillar-one.pdf (accessed 8 June 2021).
2. OECD, *Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy* – January 2020, OECD/G20 Inclusive Framework on BEPS (OECD 2020), available at https://www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf (accessed 8 June 2021).
3. *See* , for example, at the outset OECD, *Addressing Base Erosion and Profit Shifting* (OECD 2013), Primary Sources IBFD.
4. *See* *Base Erosion and Profit Shifting (BEPS): The Global Taxation Agenda* (P. Shome ed., ITRAF/Wolters Kluwer 2016), for several research papers by scholars who considered the initial challenges of the OECD/G20 BEPS Project.

a commodity or service. By and large, advanced economies had ignored this stance, their position being that revenue should accrue where risk-taking and management decisions were made, and where capital resided. However, with the collapse of revenue in advanced economies due to the 2008 global economic and financial crisis,[5]these economies began to realize the potential revenue benefits of applying the source principle, given the limits of international capital movement.

Accordingly, it has been argued increasingly that the source principle should assume permanence in the international taxation regime. Such a move would be rational. Both emerging and advanced economies, other than the United States, have been progressing towards acceptance of the ramifications of this principle.[6]Nevertheless, the debate over the OECD's Pillar One and Pillar Two proposals that has emerged in the context of the taxation of the digital economy indicates that the United States continues to be reluctant when it comes to its MNEs being taxed in source jurisdictions. It continues to insist that tax revenue should accrue, by and large, to the United States where digital companies are headquartered.[7]In sum, as Baker (2016) commented, "The MNE tax avoidance problem could be linked primarily to those MNEs with headquarters in the US".[8]

Should the concept of a PE, therefore, be redefined? The OECD's 2014 proposal of a permanent virtual establishment (PVE) was not a poor one.[9]Once an MNE's sales reach a certain level in a jurisdiction, it would be deemed to have a PE in that jurisdiction. In that case, profits from the MNE that were attributable to the virtual PE would be taxed by the source jurisdiction.

In effect, providing a healthy customer base should suffice to entitle a source state with the right to tax profits arising in, or from, that state. Such a concept would apply based on the continuous and commercially significant business activity of a non-resident enterprise in the source country. This idea matches the fundamentals behind source-based taxation. In practice, however, whether a sufficiently high sales revenue creates a legal right for a country to claim the ability to tax an enterprise, other than VAT or a goods and services tax (GST), of course, is not accepted by all, as evidenced by the ongoing international deliberations.[10]

In fact, the OECD's PVE discussion draft states that the varieties of a "virtual" presence PE are included "only for the sake of completeness".[11]Perhaps "for the sake of completeness" means that the OECD is not proposing to move forward with these suggestions at least at this time. In other words, this situation reflects a lack of enthusiasm for these alternatives as noted by experts, such as Girish[12]and others.

To sum up, countries have expressed an increasing keenness that the international taxation regime should be designed to attribute revenue among tax jurisdictions fairly. As a backdrop, it must be recalled that the international taxation regime has not been fair over the past century. This situation arose as value-added was not recognized as an appropriate criterion, but capital ownership was. That is, tax revenue did not accrue to those countries to which capital was exported and in which the value-added was created but, rather, to those countries from where capital was exported.

That convention and practice reflected the pattern of the global colonial past, although, unfortunately, it continued well after the colonies had vanished. It reflected the predominance of the OECD, an advanced economy grouping, which remained powerful in consolidating its interests. But the OECD/G20 BEPS Project challenged that pattern due to the broader inclusion of countries in the G20. Ironically, today the United States appears to be the sole visible adherent of the superiority of the residence principle.

3. Use of the Inclusive Framework to Eradicate Tax Havens

A crucial issue is the continuance of tax havens, which are an instrument for tax avoidance essentially installed and run under the auspices of various advanced economies. If the OECD in itself has a limited number of regular member countries, can it meaningfully use its Inclusive Framework, comprising 135 countries, which it formed to take forward its work on the OECD/G20 BEPS Project, to initiate reform leading to the eradication of tax havens?

It must be noted that the European Union has issued lists of tax havens of its Member States. Accordingly, should this work not be taken further by a group comprising the majority of nations, such as the Inclusive Framework? Some multilateral action

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5. *See* *The G20 Macroeconomic Agenda: India and the Emerging Economies* (P. Shome ed., Cambridge U. Press 2014), for a comprehensive treatment of the macro-economic challenges that prevailed during that period.
6. *See* H.P. Khincha, N. Khincha & P. Kothari, *Source and Nexus of Income* , in *Reimagining International Taxation* ch. 8 (P. Shome ed., ITRAF/OakBridge 2021).
7. *See* H.D. Gajaria, J. Golani & R. Karadkar, *OECD's Pillar One and Pillar Two – An Overview* , in Shome ed., *supra* n. 6 , at ch. 7.
8. P. Baker, *BEPS: Emergence of International Tax Law and Future Direction* , in Shome ed., *supra* n. 4 , at ch. 3.
9. OECD, *BEPS Action 1: Address the tax Challenges of the Digital Economy, Public Discussion Draft* , 24 Mar.-14 Apr. 2014 (OECD 2014), available at https://www.oecd.org/ctp/tax-challenges-digital-economy-discussion-draft-march-2014.pdf (accessed 8 June 2021).
10. *See India in a Global Pandemic—Macro-economic and Tax Considerations,* in Shome ed., *supra* n. 6 , at ch. 1.
11. OECD, *supra* n. 9 , at sec. 3.3.
12. *See* K.R. Girish, *A Comprehensive Overview of Shifts in International Taxation* , in *International Taxation in the Digital Era* ch. 11 (P. Shome ed., ITRAF/OakBridge 2020).

is also being taken on tax havens. The European Union took up the issue of tax havens directly in the period 2016-2019 by issuing a code of conduct, and by drawing up a blacklist[13]and a grey list of offenders. Yet, unsurprisingly, Oxfam, a non-governmental organization (NGO) that monitors MNE misbehaviour, has provided its view on this topic, raising issue with the European Union as to why some countries were in the latter list and not the former, and why some had not been included in either list. "Nevertheless, it has to be recognized that the European Union is at least addressing the issue".[14]Enhanced action against tax havens would comprise the global economic community bringing the entire tax haven matter into the open, such that the role of selected OECD member countries appears in full view of the emerging economies. Otherwise, such advanced economies can continue to hide behind initiatives like the OECD/G20 BEPS Project, while effectively enabling pervasive international tax avoidance. In such a scenario, there is little bite in calling for action against tax avoidance through limited efforts, like the OECD/G20 BEPS Project.

4. Taxation of the Digital Economy

4.1. Introductory remarks

Another lacuna that has loomed large on the OECD's unfinished agenda is the taxation of the digital economy.

4.2. OECD's Pillar One and Pillar Two proposals[15]

The OECD's Pillar One and Pillar Two proposals with regard to digital economy taxation have been deconstructed by several tax experts.[16]To recount, the backdrop of the OECD's proposals was the G20's direction to suggest cross-country taxing rights to enable the taxation of the digital economy. Pillar One and Two are the vehicles that emerged from the OECD's efforts.

Pillar One (i) focuses on the allocation of taxing rights among countries, and (ii) seeks to undertake a coherent and concurrent review of the profit allocation and nexus rules.[17]Pillar Two recommends a minimum tax on the digital economy to be introduced by all jurisdictions.[18]There is more agreement on Pillar Two than on Pillar One, reflecting the fact that the United States is more at ease with Pillar Two's minimum tax recommendation, which it employs.

In January 2020, the OECD's Inclusive Framework, comprising 135 countries, reiterated its commitment to the two-Pillar approach. It developed a note entitled, "Outline of the Architecture of a Unified Approach on Pillar One".[19]An updated Programme of Work identified 11 building blocks for further work towards a solution.[20]A progress note on Pillar Two was also agreed.[21]An Inclusive Framework meeting in October 2020 moved towards the agreement of a package. Yet, subsequently, a statement was issued indicating that the work was being set aside.[22]This clearly indicates the underlying lack of consensus on the issue. The crux of the final position rested on the United States essentially disagreeing with the view that its MNEs should be taxed in source jurisdictions, and insisting that tax revenue should accrue to the United States where digital companies are headquartered.

However, the reality is that recent digital economy and/or cyberspace business models and outsourcing allow non-residents to have a significant presence in countries without a taxable PE being there.[23]In essence, the United States does not want such non-residents to be subject to any tax on digital economy activities if the taxable nexus is based on the site of the server.

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13. In 2019, Oxfam named 23 jurisdictions that were expected to be included in a blacklist by the European Union. These jurisdictions were: American Samoa, Bahrain, Cabo Verde, the Cook Islands, Dominica, Fiji, Grenada, Guam, the Marshall Islands, Morocco, Nauru, New Caledonia, Niue, Oman, Palau, Saint Kitts and Nevis, Samoa, Trinidad and Tobago, Turkey, the Turks and Caicos Islands, the United Arab Emirates, the US Virgin Islands and Vanuatu. *See* Oxfam, *Assessing Jurisdictions Against EU Listing Criteria,* (Oxfam Mar. 2019), available at https://oxfamilibrary.openrepository.com/bitstream/handle/10546/620625/tb-off-the-hook-tax-havens-methodology-070319-en.pdf (accessed 9 June 2021). In a 2020 update, Oxfam commented that many tax havens that facilitated tax avoidance through zero-tax rates, such as Bahamas, Bermuda, British Virgin Islands, Guernsey, Isle of Man and Jersey, were also excluded from the blacklist. The reason was that the European Union did not consider zero-tax rates, or minimal tax rates, a criterion to identify taxhavens; such rates were merely a "risk indicator" for the EU blacklist assessment. It is obvious that there is reason to support an argument that they should be included in a blacklist. *See* Oxfam, *EU tax haven blacklist review* (Oxfam Feb. 2020), available at https://oi-files-d8-prod.s3.eu-west-2.amazonaws.com/s3fs-public/2020-02/2020-02-17%20Oxfam%20background%20briefing%20-%20EU%20tax%20haven%20list.pdf (accessed 8 June 2021).
14. *See* P. Shome, Rejoinder to P. Baker, *The Need for A New International Tax Architecture* , in Shome ed., *supra* n. 6 , at p. 67.
15. Id., at ch. 31.
16. *See* , for example, H.D. Gajaria, J. Golani & R. Karadkar, *supra* n. 6 , at ch. 7.
17. OECD, *supra* n. 1 , at section 2.1.
18. OECD, *Global Anti-base Erosion Proposal ("GloBE")-Pillar Two* , Public consultation document, 8 Nov.-2 Dec. 2019 (OECD 2019), available at https://www.oecd.org/tax/beps/public-consultation-document-global-anti-base-erosion-proposal-pillar-two.pdf.pdf (accessed 8 June 2021).
19. OECD, *supra* n. 2 , at Annex 1.
20. OECD, *supra* n. 2 , at Annex A.
21. OECD, *supra* n. 2 , at Annex 2.
22. OECD, *Cover Statement by the Inclusive Framework on the reports on the Blueprints of Pillar One and Pillar Two* (OECD 2020), available at https://www.oecd.org/tax/beps/cover-statement-by-the-oecd-g20-inclusive-framework-on-beps-on-the-reports-on-the-blueprints-of-pillar-one-and-pillar-two-october-2020.pdf (accessed 8 June 2021).
23. *See* P. Shome, Rejoinder to H.D. Gajaria, J. Golani & R. Karadkar, *OECD's Pillar One and Pillar Two – An Overview* , in Shome ed., *supra* n. 6 , at ch. 7.

Accordingly, a tax based on the source of such income generated within its jurisdiction, which is often the emerging economy, is unacceptable to the United States.

In the absence of a multilateral consensus, countries have begun to take unilateral measures that are designed to generate revenue on a source basis to tax the digital economy. India's equalization levy could be perceived as an aspect of source-based taxation, i.e. where the turnover is generated. Accordingly, perhaps the source principle should assume permanence in international tax rules. It is rational and both emerging and advanced economies, other than the United States, have been progressing towards accepting the ramifications of the source principle.

There has been criticism as to how much revenue source countries should obtain if the source principle were to be followed.[24]This situation reflects the calculation of revenue accruals based on tranches that would ensure that residence jurisdictions would continue to receive a significant portion of the revenue. Essentially **,** under the OECD's proposals, (i) the first allowable Amount (A) is too small, while (ii) the subsequent Amount (B) is truncated by prevailing limits and arbitration that are likely to favour residence countries.[25]Gajaria, Golani and Karadkar (2021) have explained the calculations in some detail.[26]Tax experts have expressed views that, given the various checks and balances of thresholds and the mandatory acceptance of any arbitration that may result, the likely revenue outcomes would not be great.[27]

Pillar Two was based on the US Tax Cuts and Jobs Act (TCJA) of 2017[28]and implemented as a modified version of US Global Intangible Low-taxed Income (GILTI) and the Base Erosion and Anti-abuse Tax (BEAT), which are minimum taxes on both outbound investment and inbound investment. Under Pillar Two, there should be a minimum residence tax if the source country does not tax, such as in GILTI, and a minimum source tax if the residence country does not tax, being a modified version of the BEAT. The minimum tax rates under Pillar Two would be low, and would be subject to limits. So, the revenue raised would not be significant.

A final question remains. As electronic commerce (e-commerce) is mobile, where do "mind and management" – the principle behind residence-based taxation – really reside? It remains difficult to pin this principle down, particularly in the context of the digital economy.

4.3. UN recommendations on the taxation of the digital economy

The OECD was not the only player in relation to the taxation of the digital economy. The UN has made its own proposals. In August 2020, the UN proposed an optional provision to be added to the UN Model (2017),[29]granting additional taxing rights to countries where an automated digital services provider's customers are located.[30]The tax base would include payments for services provided on the Internet or an e-network requiring minimal human involvement from the service provider. Consequently, the tax base would include the sale, and other alienation, of user data.

The activities covered would include the provision of online advertising services, online intermediation platform services, social media services, digital content services, cloud computing services and standardized online teaching services. Drawn up by an ad hoc drafting group, the UN proposal differs from the OECD's Inclusive Framework's unified approach to Pillar One, though both the OECD and the UN proposals have as their objective the granting of greater taxing rights to source countries. The UN proposal cites the following two routes for source countries to tax cross-border payments for automated digital services: (i) a "gross-based tax" at a rate agreed upon by the two treaty parties; and (ii) a net income-based tax using an apportionment formula. However, the UN also highlights problems with route (i).

The UN net income formula would apportion 30% of net income from automated digital services to the countries in which the sales revenues arise. This position is broader than that of the OECD, as it does not have the size, profitability or local revenue thresholds that are in the OECD's Pillar One. It is also more straightforward in determining taxable income in the source country without any thresholds.

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24. *See* , for example, H.P. Khincha, N. Khincha & P. Kothari, *supra* n. 6 , at ch 8.
25. The original Pillar One of 9 October 2019 set up three taxing rights for the market economies: amounts A, B, and C. The Blueprint for Pillar One dropped Amount C. As a result, now there are now only Amounts A and B. *See* G. DeSouza, *Blueprint on Pillar One – What's New and Important* (3 November 2020), Bloomberg Tax (3 Nov. 2020), available at https://news.bloombergtax.com/transfer-pricing/blueprint-on-pillar-one-whats-new-and-important (accessed 15 Apr. 2021).
26. Gajaria, Golani & Karadkar, *supra* n. 7 , at secs. 3 and 4.
27. *See* , for example, R.S. Avi-Yonah, *UTDT Global Tax Talks* , Universidad Torcuato Di Tella (UTDT) (26 Aug. 2020), available at www.youtube.com/watch?v=FmNqrFXoT5U&list=PLmZkgXYrGwgjLtF0z62Thp1_My9OZyqU9&index= (accessed 15 Apr. 2021).
28. US: Tax Cuts and Jobs Act (TCJA) of 2017, 131 Stat. 2054.
29. *UN Model Double Taxation Convention between Developed and Developing Countries* (21 Nov. 2017), Treaties & Models IBFD.
30. *See* J. Martin, *UN committee proposes new model treaty provision altering taxation of automated digital services* , MNE Tax (6 Aug. 2020), available at https://mnetax.com/un-committee-proposes-new-model-treaty-provision-altering-taxation-of-automated-digital-services-39609 (accessed 15 Apr. 2021).

4.4. Equalization levies: Cross-country experience

Under Action 1 of the OECD/G20 BEPS,[31]which laid the foundation for the taxation of the digital economy, a Task Force for the Digital Economy (TFDE) identified one alternative to taxing the digital economy. This was an equalization levy, which was a unilateral interim measure that a country could take to tax the digital economy. In this context, the levy could be limited to those businesses that engaged in transactions through a digital platform.

In 2018, the European Union proposed a 3% digital services tax (DST) on gross revenue from activities where users played a major role in creating value. It was to be levied on a list of selected digital activities. Several countries started implementing the unilateral measure. Italy introduced a new web tax and unilaterally amended the definition of PE to tax the digital economy, i.e. to have a PVE. The United Kingdom introduced the concept of diverted profits tax (DPT) to tax diverted profits that arose to an entity in an accounting period. France, India, Italy and Turkey have also done so. France's tax base is narrow, India's is potentially wider.

4.5. India's equalization levy

4.5.1. The structure

A government-appointed committee constituted in 1999 submitted a report in 2001. The committee examined e-commerce transactions under existing taxation laws. It also considered the issue of characterizing the income arising from digital transactions, and advocated a broader interpretation of the terms "royalty" and "fee for technical services".

Another government committee was constituted in 2016 to examine the taxation of the digital economy. The committee analysed alternatives proposed by the OECD. It concluded that the option of introducing the concept of significant economic presence (SEP) or levying withholding tax would require amending tax treaties. Accordingly, India introduced a 6% equalization levy by way of its annual budget law – The Finance Act (FA)[32]– in 2016, on the turnover of non-resident taxpayers with no PE in India supplying specified digital services so as to equalize the tax burden with domestic suppliers.[33]The equalization levy was reduced to 2% by the FA 2020,[34]and its scope extended to e-commerce companies services intended for consumption by Indian residents and persons taking advantages of such services using an Indian Internet Protocol (IP) address.

The equalization levy effectively includes hotel bookings and software purchases in respect of the purchase of components from overseas. It could also have an effect on the business models of e-commerce giants, such as the Walmart-owned Flipkart and Amazon and Club Factory.[35]

4.5.2. A lingering lack of clarity

Analysts have noted several unclear elements with regard to the equalization levy. The coverage of the equalization levy could extend to a transaction with no relation whatsoever with India. For instance, a person present in India ordering goods from Amazon to be delivered to, and paid for, by a relative residing in the United States would be covered by its all-embracing scope. This position is contrary to the design considerations for equalization levies as suggested by the OECD in 2015, which limited its application to non-residents with a SEP in the country.

Many Internet users resort to a Virtual Private Network (VPN) for a secure connection or to avoid geographic restrictions on websites. This situation is a challenge that must be dealt with. A literal interpretation of the provision might mean that a foreign internet user using an Indian IP address on a VPN would fall within its scope. Accordingly, applying the equalization levy based on the use of an Indian IP would compel e-commerce operators to go to great lengths to ensure that they have sufficient means and infrastructure to identify and distinguish IP addresses.

The term "consideration received or receivable" used in the FAs has given rise to a dubious situation for the e-commerce operators. There does not appear to be much clarity on whether the equalization levy should be levied on the gross amount received by the operator from the customer or on the fee charged by the operator for its facilitation services. The difference is significant in revenue terms and in the generation of market distortions. This depends on how the payment mechanism works. Some operators retain commission from the gross amount received from the customer before sending the balance to the seller. Under other models, the entire gross amount is sent to the seller, and the operator receives commission thereafter. These two approaches would imply a significant difference in the tax base. If the former base were to apply, the seller would be subject to

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31. *See* , for example, OECD, *Action 1 Final Report 2015 – Addressing the Tax Challenges of the Digital Economy* (OECD 2015), Primary Sources IBFD.
32. IN: Finance Act (FA) 2016.
33. *See* V. Agarwal & A.P. Kumar, *Challenges in the Design of Digital Taxation in India* , in Shome ed., *supra* n. 12 , at ch. 3.
34. IN: FA 2020.
35. *See* D.P. Behera & H. Kumar, *Equalization Levy on Non-Resident E-commerce Players: India's Ace in the Hole or a Stumbling Block for Foreign Players?* , International Centre for Tax and Development (ICTD) (4 Aug. 2020), available at www.ictd.ac/blog/equalization-levy-non-resident-ecommerce-india-block-foreign-players/ (accessed 15 Apr. 2021).

the equalization levy in the hands of e-commerce operators on the gross amount received, as the wording of the law regarding the equalization levy could be misinterpreted to infer that the entire amount paid by the customer, and initially received by the e-commerce operator, would be subject to equalization, and not just the commission that the e-commerce operator earns from such transaction.[36]

A critique of the unilateral measures being adopted by countries to tax the digital economy has been that it results in double taxation. The equalization levy imposed in India is no different. First, it leads to double taxation according to the domestic laws due to its coverage in the GST base, though the equalization levy may be regarded as an income tax. Second, the equalization levy may result in international double taxation if the state of residence does not provide any credit in respect of the levy paid in the source country under its domestic laws.

Currently, there are no provisions under any of the tax treaties entered into by India that bind the state of residence to provide for any relief in respect of any equalization levy paid. Of course, there is no expressed or even implied bar to impose a tax that results in double taxation. Tax statutes cannot be invalidated merely on the basis of the argument that the levy results in double taxation. However, though legally there is no bar on taxing the same subject twice, such a situation is undesirable if economic growth is not to be jeopardized by double taxation.[37]

Even though the equalization levy has been imposed with a sound objective, in its current form, it may be burdened with too many questions of compatibility with international taxation. Other emerging economies may emulate India and endeavour to include a digital tax within their own taxation frameworks, though it may not be the best idea to introduce an equalization levy in its prevailing forms. In this regard, several tax experts in India are currently analysing the problem so as to be able to recommend possible ways to tax the digital economy better.[38]

4.5.3. US reaction to the equalization levy

The United States views the equalization levy and other prevailing digital economy taxes as ring-fencing the digital economy. In 2019, the Office of the US Trade Representative (USTR) initiated an investigation into the 3% DST adopted by France on revenue generated from certain digital services provided to, or targeted at, persons in France. On completion, the USTR concluded that the French DST was unreasonable, unfair and discriminatory towards US commerce. The French DST was applied to revenue rather than to income and, therefore, was inconsistent with accepted principles of international tax policy. Further, it was retroactive and extraterritorial in its application. It was held to discriminate against US companies. Accordingly, the United States set a deadline of 6 January 2021 to impose a 25% tariff on French cosmetics, handbags and other imports valued at approximately USD 1.3 billion, although, at the time of writing this article, actual collection was not reported to have begun.

As events unfolded, it was reported on 7 January 2021[39]that the USTR had also found India, Italy and Turkey had discriminated against US tech firms, such as Amazon, Apple, Facebook and Google. The USTR elaborated that the taxes were "unreasonable" because they were:

> inconsistent with principles of international taxation, including due to its application to revenue rather than income, extraterritorial application, and failure to provide tax certainty.

To conclude on this point, the rapidly emerging developments in the unilateral actions on the digital economy taxation and widely targeted US reaction against them could be the harbinger for retaliatory tariffs, though such tariffs were not immediately specified. Nevertheless, these countries must reflect on the need for tax revenue given the adverse effects of the COVID-19 pandemic. Can they readily abandon a revenue base simply because the international taxation community is slow in finding a solution for its appropriate taxation? They need to weigh their revenue requirements against the increased post-tariff product prices at market entry and the associated reduction in the international competitiveness of domestic firms on which the burden of US tariffs would fall.

To sum up, any equilibrium in the form of multilaterally agreed taxation of the digital economy is yet to be achieved. Instead, an increasingly fractured structure of digital taxes and commodity counter-tariffs seems to be here to stay for the foreseeable future.

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36. Id.
37. *See* Agarwal & Kumar, *supra* n. 33 .
38. *See* V. Agarwal et al., *Removing Roadblocks in Taxing Business Income in the Digital Era: Building Global Consensus for an Equitable Solution* (June 2020), Vidhi Ctr. Leg. Policy and BMR Leg. Advocates, available at https://vidhilegalpolicy.in/wp-content/uploads/2020/06/20200620_-Digital-Economy-report-VIDHI-and-BMR.pdf (accessed 15 Apr. 2021).
39. *See* D. Lawder, *USTR slams India, Italy, Turkey on digital taxes but holds off on tariffs* , Reuters (7 Jan. 2021), available at www.reuters.com/article/usa-trade-digital-tax/update-1-ustr-slams-india-italy-turkey-on-digital-taxes-but-holds-off-on-tariffs-idUSL1N2JH34Z (accessed 15 Apr. 2021).

5. Retrospective Taxation[40]

Another challenging issue in designing taxes that the OECD should ideally take up is how adversely retrospective taxation could affect business decisions and, therefore, a country's GDP. A concern that has emerged is that the legal constructs around retrospective taxation contradict "common sense" in the framing of tax law. And retrospective taxation can affect business decision-making adversely and severely. Let me explain.

Say a business decides to invest in year t, taking into account its risk preferences. If, for example, in year t+5, five years after its investment decision and during full-fledged operation, the government declares that the tax law has now been changed, and that it will be applied from five years prior to the present, that is from year t. In these circumstances, the basis of the original investment crumbles. Effectively, the government informs the business investor today, in year t+5, that the law five years back in time, at year t, was actually different from what it had been back in time in year t.

Such retrospectivity in taxation makes a business decision to invest, taken in the past, untenable. If unanticipated taxes have to be paid in significant amounts at a time in the future, the earlier cost, income and profit calculations are made baseless. This situation leads to what the author terms an "impossibility to perform".[41] The effect goes beyond any risk planned or accounted for by the investor. Though the investor can assess risk based on the "attitude towards risk", a retrospective tax takes the investor into a realm of "uncertainty", about which the investor possesses little ability to assess. Accordingly, the investor is robbed of a planned approach to business decision-making and management.

Yet certain tax jurisdictions have tended to adopt this approach in redefining the legal interpretation of the law with the objective of capturing revenue already apparently lost. This policy fundamentally opposes taxpayer rights that should be protected in taxpayer charters. On the other hand, if taxpayers, particularly MNEs, indulge in sustained tax avoidance by taking advantage of loopholes available in different tax statutes worldwide, global authorities can intervene and install detailed reporting requirements and mechanisms for the exchange of information amongst themselves.

MNEs have complained that retrospective legislation results in the scaling back or withdrawal of investments in such jurisdictions. And such withdrawals can be effected quickly, thereby reflecting the great mobility of international capital. What is often missed is that lower investment leads to lower economic growth and, therefore, to lower tax revenue collection. And the deleterious effects on growth can be near-permanent, rather than merely transitory.

The effect on economic growth should be a compulsory aspect of the training of tax officers, setting aside the usual practice of keeping it outside their area of concern. It is ironic that policymakers express concern about, and attempt to measure, GDP growth rates constantly. Yet, their tax officials remain oblivious to how their drive in respect of certain matters regarding tax legislation and their implementation can directly contradict economic growth. International taxation does not comprise the daily concern of policymakers, who, on being elected, may suddenly find themselves having to deal with the intricacies of international taxation. They may not possess the wherewithal of pushing strongly, when needed, against their tax officials.

Consequently, if tax law is not designed to protect against significant setbacks in economic growth, for example if retrospective taxation is introduced to suit an administration's will, taxpayers are bound to express dissatisfaction eventually. And, if the judiciary is unbiased, the courts are likely to interpret the law in favour of taxpayers. Usually, however, tax laws are prospective and provide protection from both retroactivity, i.e. transactions completed, and retrospectivity, i.e. transactions in progress, for taxpayers.

These issues have assumed significance, in particular, in the context of India's recent declining GDP,[42] to rectify which increasing investment, including foreign direct investment (FDI) is crucial. To expect investment — both domestic and foreign — to increase on a large scale while a regime of retrospective application of tax law is prevalent is folly. Unless this policy is reined in through changes in the law and only the prospective application of tax changes is assured, tax will continue to determine GDP, rather than tax being the outcome of GDP and GDP growth.

Several authors have made efforts to bring the issue of retrospective taxation to the attention of policymakers over the last decade.[43] Their work has been cited in ongoing academic work, court judgments and international arbitral awards, including in the recently published arbitral award of the Permanent Court of Arbitration (PCA) in *Cairn* (2020),[44] which cited Baker and

40. P. Shome, *Tax Base Erosion and Profit Shifting (BEPS)* , in *Taxation History, Theory, Law and Administration. Springer Texts in Business and Economics,* ch. 28 (Springer 2021), Online Books Springer, available at https://doi.org/10.1007/978-3-030-68214-9_30 (accessed 20 Apr. 2021).
41. *See* IN: Expert Committee Report on Retrospective Amendments Relating to Indirect Transfers, Ministry of Finance, Government of India (2012), which this author chaired.
42. *See* P. Shome, Rejoinder to N. Nigam, *Retrospective Taxation and the Vodafone Case* , *supra* n. 6 , at ch. 4.
43. *See* , for example, H. Salve, *Retrospective Taxation – The Indian Experience* , (Bingham Centre Working Paper 2014/06), Bingham Centre for the Rule of Law, BIICL (Sept. 2014), available at https://www.biicl.org/documents/315_tax_booklet_-_final.pdf (accessed 9 June 2021).
44. UK: PCA, 21 Dec. 2020, *Cairn Energy PLC and Cairn UK Holdings Limited v. The Republic of India* , PCA Case No. 2016-07. N. Nigam *, Retrospective Taxation and the Vodafone Case,* in Shome ed., *supra* n. 6 , at ch. 4, references to Baker and Shome are grouped together in Appendix 1.

Shome exhaustively.[45]That work will continue until the issue of retrospective taxation giving rise to impossibility for businesses to perform is resolved.

6. New International Tax Architecture

6.1. Locating the international taxation regime at the UN

Reflecting the flux in the outcomes that the OECD has been able to achieve despite the appropriate direction it adopted in the OECD/G20 BEPS Project, some experts have been critical regarding this issue. For instance, Baker (2021)[46]has expressed concern about the dispersion of the prevailing international taxation architecture, which is currently spread across the OECD, the UN, the International Monetary Fund (IMF) and the World Bank. His view is that the OECD's emergence as the flag holder over the UN in this field was almost an accident. He is critical of the OECD's "consensus approach", which limits the possibilities of arriving at meaningful solutions to any issue, even while, as an organization, it possesses little democratic legitimacy. His most crucial conclusion is that, even in the G20 initiated OECD/G20 BEPS Project, the project has been found to be focussed on, and biased in favour of, advanced economies. In the final analysis, the OECD/G20 BEPS Project is found to be led by a single country **,** thereby jeopardizing the international taxation architecture.

Baker's view is that the correct location for the international taxation architecture should be the UN, where the interests of all countries may be appropriately represented. However, Baker himself comments that there would have to be fundamental reforms within the UN structure for it to take over the functioning of the international taxation architecture meaningfully.

Further, the question must also be asked as to whether, at this time, there is any critical mass in agreeing or financing moving the location of the international taxation architecture to the UN. In this regard, there is little evidence of the appropriate organization at the UN for moving this issue forward successfully.

6.2. A global tax authority as an ultimate goal

Against this backdrop, while awaiting cross-country agreement regarding the location of the international taxation architecture at the UN, could a global fiscal and/or tax organization be designed, and could the Inclusive Framework take the formulation of such an organization forward? Such a concept has been discussed since the 1980s, one of the initiators being Tanzi (1988).[47]Subsequently, Shome (1996) elaborated on the concept of international tax organization.[48]

Tanzi in 1988 mooted the idea of a Global Tax Authority (GTA) some time ago. Accordingly, this is not altogether a new idea. However, at that time, the required commitment from nation states would have been enormous, as it would have implied an intrinsic change in the ways in which governments of different political persuasions functioned, i.e. some sacrifice of individual national sovereignty for the sake of the global good.

Prevailing conditions have changed in the face of repeated global economic, financial and fiscal crises. A GTA is essential now because of the proliferation of tax evasion and the need to consolidate the exchange of information among tax authorities. An important advantage of such a consolidated approach would be that of the designated vehicle in the form of a GTA, rather than dependence exclusively on bilateral tax treaties or individual countries bearing the responsibility of attaining this global objective.

Evasion has continued to take various forms. These forms include: (i) failure to file information, reports or returns; (ii) "daisy chain" schemes involving the use of dummy companies that could claim to have paid the tax through a chain of complex paper transactions; (iii) failure to pay taxes that have been already assessed or agreed on by, say, setting up dummy corporations showing little assets; (iv) filing false returns by claiming excessive inputs; and (v) evasion associated with fuel excise taxes.[49]A GTA would be more able to address these forms of evasion on the basis of being able to access more comprehensive information.

As a result, a GTA would have to employ several methods, in relation to both direct and indirect taxation. To cite a just few, these methods would encompass: (i) improving regulations for the screening, licensing and bonding of taxpaying entities; (ii) introducing innovative measures, such as exclusive fuel coloration in the case of fuel exports and imports; (iii) enforcing cross-border invoice requirements more thoroughly than at present; (iv) developing a mechanism for carrying out selective cross-

45. Baker, *supra* n. 44 was referred to exhaustively in *Cairn* (2020), *supra* n. 44 , at pp. 280, 281, 468, 497, 502, 503 and 504. Similarly, Shome was referred to for his previous work and roles, either directly or through committee or commission chairmanships, in *Cairn* (2020), *supra* n. 44 , at pp. xi, 40, 213, 214, 220, 252, 255, 281, 289, 294, 295, 296, 297, 303, 490 and 500.
46. P. Baker, *The Need for a New International Tax Architecture* , in Shome ed., *supra* n. 6 , at ch. 3.
47. *See* V. Tanzi, *Forces that Shape Tax Policy* , in *Tax Policy in the Twenty-First Century* (H. Stein ed., John Wiley and Sons 1988).
48. *See* P. Shome, *A 21st Century Global Carbon Tax* , 50 Bull. Intl. Taxn. 11/12 (1996), Journals IBFD.
49. *See* A.T. Reno, *Measures to Curtail State Fuel Tax Evasion* , Natl. Coop. HwY. Research Program Paper No. 164, Transp. Research Bd., Natl. Research Council (Oct. 1990).

country audits; (v) continuously monitoring and practising modes of inter-administration cooperation; and (vi) enforcing criminal penalties where appropriate. Though Action 13 of the OECD/G20 BEPS Project[50] deals with issue (v), consolidating such action under a GTA would provide a much more effective instrument for achieving this end.

While it would have obvious pecuniary and opportunity costs, higher expenditure of global monies and would be yet another international bureaucracy, its benefits should compensate for the costs. Existing multilateral institutions whose mandates mainly comprise international monetary stabilization should not be burdened with additional tasks, given the phenomenal increase in the complexities in world financial markets. A new, autonomous and streamlined GTA, therefore, deserves serious consideration.

Tanzi (2016)has continued to write on the matter, indicating that the time may have arrived for establishing a GTA that would monitor tax developments that have global implications.[51] He elaborates on the role that such an institution could play. He also notes the obstacles to creating such an institution and the shape it might take realistically under the prevailing global environment.

Tanzi clarified that:

> [...] a GTA would not collect taxes, although a time might come for such a role to finance global "public goods", but that would help bring order in the tax policies of countries, especially in those that have cross-countries' implications. In the absence of such an institution, some of the problems connected with unfair tax competition, with international tax avoidance, and with the "poaching" of other countries' tax bases are likely to intensify, contributing to progressively more serious macro-economic difficulties for some countries and to the reduction of some governments' ability to deal with domestic social problems.[52]

To sum up, it is needless to say that immense multilateral efforts and agreements would be needed to successfully establish a GTA, but, under the prevailing global, COVID-19 pandemic-driven fiscal crisis, there could be no better moment for all of the concerned countries to move in this direction. The outcome would be the reform of the international taxation architecture through a multilateral tax organization, thereby reducing international tax avoidance, enabling the rationalization of tax structures and promoting more efficient and streamlined national tax administrations. In turn, the reformed international taxation architecture would likely result in improved global revenue generation that is needed to move towards closing the significant fiscal gaps prevalent in most countries.

Nevertheless, it appears that the time for both the idea of shifting the international taxation regime to the UN and that of establishing an independent international taxation architecture has not yet arrived. In this environment, the potential role of the Inclusive Framework must be highlighted through which major challenges that continue to haunt the adequacy of taxation can be confronted meaningfully and resolved in terms of fair revenue collection and its cross-country allocation.

7. Conclusions

In fiscal terms, there is no way out of the COVID-19 pandemic except through a carefully designed increase in taxes. The solution lies in introducing a wealth tax and a super-rich income tax, while, at the same time, reducing incentives in respect of corporate income tax complemented by tax administrative reform and, in the area of international taxation, pushing for fairness in revenue sharing among tax jurisdictions. Poorer countries can also approach multilateral institutions for loans on easy terms that are designed, in particular, to address crisis conditions. Ironically, it would not be entirely surprising, even for advanced economies, to approach the IMF for loans to help ease their economic distress.

Humankind has faced enormous challenges through the course of its history and has, so far, survived them. On a philosophical note, Tanzi (2021)[53] has recently stated that:

> [...] the ongoing pandemic has exposed some major weaknesses that may exist in the competitive, democratic system that we as economists have admired and have promoted, over the years. It is not easy to think of satisfactory alternatives to that system. However, it is easier to argue that, in a world in which major disasters and pandemics exist, and may become more frequent, because of climate change and other developments, we will need some new thinking, that might suggest some desirable ways to change the modus operandi that we have admired up to now. That thinking should suggest ways to still promote efficiency, an objective that cannot be abandoned, and democracy. But the new ways should do a better

50. *See* , for example, OECD, *Action 13 Final Report 2015 – Transfer Pricing Documentation and Country-by-Country Reporting* (OECD 2015), Primary Sources IBFD.
51. *See* V. Tanzi, *Lakes, Oceans, and Taxes: Why the World Needs a World Tax Authority* , in *Global Tax Fairness* (T. Pogge & K. Mehta eds., Oxford U. Press 2016), Oxford Scholarship Online **,** available at https://oxford.universitypressscholarship.com (accessed 11 May 2021).
52. Id., at ch. 11, p. 264.
53. *See* V. Tanzi, *Perfect Markets, Perfect Democracies and Pandemics* , Transformation, Integration & Global., Econ. Research Working Paper Series No. 142 (2021).

> job in dealing with major shocks, including pandemics, and with equity consideration of economic policies that often receive little attention in mainstream economics. As Rita Levi Montalcini[54]wrote four decades ago, let us hope that some good may come from the difficult moment that we are experiencing.[55]

Tanzi goes on to quote Montalcini:[56]

> It is imperfections — not perfection — that is the end result of the programme written into the formidable complex engine that is the human brain, and of the influences exerted upon us by the environment and whoever takes care of us during long years of our physical, psychological and intellectual development... don't fear difficult moments, [because] the best comes from them.[57]

It is to be hoped that the COVID-19 pandemic is drawing together invaluable lessons from which humankind can take strong and meaningful action. Internationally, a global carbon tax to arrest climate change could be employed if a drive could be instituted to introduce such a tax instrument. Easing international trade rather than putting barriers on it, with powerful countries standing back from hegemonic positions and obstacles, would also be a step forward. Domestically, all countries should enhance equity in their taxation systems for the pandemic has resulted in a rapidly worsening income distribution. Emerging economies, in particular, should improve tax administration to remove barriers to investment and enable a recovery in economic growth by making the tax responsibility easier to comply with. A new era cannot emerge without such fundamental steps that have always been easy to perceive though difficult to achieve. The human race is at this doorway. A forward step must be taken globally, together and as a whole. And it must be complemented with resolute action by individual nations to buttress the global socio-economic condition.

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54. R.L. Montalcini, an Italian biologist, won the Nobel Prize in medicine in 1996.
55. Tanzi, *supra* n. 53 , at p. 4.
56. *See* R.L. Montalcini, *In Praise of Imperfections: My Life and Work* (Basic Books 1988).
57. Tanzi, *supra* n. 53 , at p. 1.