Julia Sinnig

Taxation, Data and Destination

An Analysis of Destination-Based Taxation from the Perspective of Tax Principles and Data Protection Regulation

IBFD DOCTORAL SERIES 64

Taxation, Data and Destination

Why this book?

The digitalization of the economy raises various new legal questions. International corporate taxation encounters situations it has not known before, being traditionally based on a physical nexus of businesses in their States of residence or source. In the past years and in the framework of the BEPS project, the OECD and its "Inclusive Framework" of 140 countries extensively discussed potential modifications of existing tax rules to adapt these rules to the economic reality of digitalized business models.

The book contributes to this discussion by analyzing two destination-based corporate tax models and their application to different types of digitalized business models as well as their compliance with EU and international tax and data protection law frameworks. On the one hand, it provides an extensive analysis of the model tax of a "destination-based cash-flow tax" as developed by economists already long before the discussion about "taxing the digital" arose. On the other hand, the author develops a "digitalized destination-based corporate tax", which should replace corporate income tax for covered taxpayers and combines elements of the much-discussed digital services taxes and traditional corporate income tax.

The legal analysis provided in this book focuses on the conformity of these two model taxes with double taxation conventions based on the OECD and UN Model Conventions, EU fundamental freedoms and state aid provisions as well as relevant EU secondary law, and WTO law. Moreover, the author analyses the compliance of a corporate tax nexus based on the location of the corporate taxpayer's users or clients with the EU Charter of Fundamental Rights, the European Convention on Human Rights and the General Data Protection Regulation.

The principal insights of this work concern the viability of destination-based taxation as a solution for the tax problems arising from digitalized business models and the exact definition of "destination" in this context. Furthermore, the new tax proposal of a digitalized destination-based corporate tax comes as a compromise between more radical solutions and can be adopted in compliance with the analyzed legal frameworks, where taxation source rules remain linked to user's residence rather than more precise locational data.

Title:	Taxation, Data and Destination
Author(s):	Julia Sinnig
Date of publication:	June 2022
ISBN:	978-90-8722-778-4 (print), 978-90-8722-779-1 (ePub), 978-90-8722-780-7 (PDF)
Type of publication:	Book
Number of pages:	400
Terms:	Shipping fees apply. Shipping information is available on our website
Price (print/online):	EUR 110 / USD 130 (VAT excl.)
Price (eBook: ePub or PDF):	EUR 88 / USD 104 (VAT excl.)

Order information

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www.ibfd.org

ISBN 978-90-8722-778-4 (print)
ISBN 978-90-8722-779-1 (eBook, ePub); 978-90-8722-780-7 (eBook, PDF)
ISSN 1570-7164 (print); 2589-9619 (electronic)
NUR 826

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Chapter 1

Introduction

> "Über den Zweck dieser Welt, über den Sinn des Lebens, über den Sinn von vielleicht Sinnlosem braucht der Steuerphilosoph nicht zu spekulieren oder zu reflektieren. *Die Probleme* der Steuergerechtigkeit sind keine transzendenten; sie *müssen hier gelöst werden, hier und jetzt*."
>
> Klaus Tipke, *Die Steuerrechtsordnung* p. 262 (Dr. Otto Schmidt 1993). [Emphasis added]

1.1. Presentation of the topic and problems

"Taxing the digital" is a major challenge to the international tax order in the 21st century, and this book attempts to contribute to the response to this challenge. More than 15 years ago, the risk of tax revenue loss due to electronic commerce (e-commerce) in source states had already been predicted.[1] This tax revenue loss is mainly due to the lack of permanent physical presence[2] and hence the attainment of the permanent establishment (PE) threshold[3] in countries other than the residence country. The initial allocation[4] of taxing rights in double taxation conventions (DTCs) between residence and source states, as a result of the PE threshold being passed, becomes unbalanced.[5] Consequently, business profits of enterprises whose business

1. A.J. Cockfield, *Transforming the Internet into a Taxable Forum: A Case Study in E-Commerce Taxation*, 85 Minnesota Law Review, p. 1174 (2001).
2. *See*, e.g. J. Becker, J. Englisch & D. Schanz, *A SURE Way of Taxing the Digital Economy*, 93 Tax Notes International, p. 309 (2019).
3. *OECD Model Tax Convention on Income and on Capital* art. 5(1) (21 Nov. 2017), Treaties & Models IBFD [hereinafter OECD Model] reads: "For the purposes of this Convention, the term 'permanent establishment' means a *fixed place of business* through which the business of an enterprise is wholly or partly carried on" [emphasis added].
4. Such initial allocation has been negotiated at the birth of the international tax order, the foundations of which remain valid today. This birth is traced back mainly to the report addressed by the four economists Gijsbert W.J. Bruins, Luigi Einaudi, Edwin R.A. Seligman and Sir Josiah Stamp to the League of Nations in 1923: G.W.J. Bruins et al., *Report on Double Taxation submitted to the Financial Committee*, E.F.S.73. F.19 (5 Apr. 1923). The technical nuances of the principles stated in the 1923 Report and first model conventions from 1927 have been further developed in double taxation convention (DTC) models, developed by the fiscal committee of the League of Nations, such as the Mexico Model Convention of 1943, the London Model Convention of 1946 and later the OECD Model, which was first published in 1963. *See also* H. Krabbe et al., *Vor Art. 1 – Vorbemerkung*, in *Doppelbesteuerung – Kommentar zu allen deutschen Doppelbesteuerungsabkommen* m. no. 76 et seq. (150th ed., F. Wassermeyer et al. eds., C.H. Beck 2020).
5. *See*, e.g. J.M. Graetz, *The David R. Tillinghast Lecture, Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 54 Tax Law Review

models function without necessitating physical presence in the source state face an exclusive residence state taxation according to article 7(1) of the OECD Model Tax Convention on Income and on Capital (OECD Model).[6]

Since the profits do not remain untaxed, one may wonder whether exclusive residence state taxation is problematic.[7] In that respect, the criticism is mainly that corporate residence can be comparatively easily manipulated by corporate taxpayers, as in most states a formal act is sufficient to constitute residence for tax purposes (place of incorporation/registration).[8] As this results in a situation where corporate taxpayers can more or less arbitrarily choose their place of taxation, and consequently opt for residence in countries with a beneficial tax system,[9] the source concept within the framework

3, p. 269 (2001); W. Schön, *International Tax Coordination for a Second-Best World (Part I)*, 1 World Tax J. 1, pp. 67-68 (2009), Journal Articles & Opinion Pieces IBFD; W. Cui, *Minimalism about Residence and Source*, 38 Michigan Journal of International Law, pp. 245 and 248 et seq. (2017); and M. Devereux & J. Vella, *Are We Heading towards a Corporate Tax System Fit for the 21st Century?*, 35 Fiscal Studies 4, p. 461 (2014). Note, however, that it has been criticized that this initial allocation of taxing rights has in any case been an arbitrary choice, *see*, e.g. K. Vogel, *Worldwide vs. source taxation of income: A review and re-evaluation of arguments (Part I)*, 16 Intertax 8/9, p. 216 (1988); K. Vogel, *"State of residence" may as well be "state of source": there is no contradiction*, 59 Bull. Intl. Fiscal Docn. 10, p. 420 (2005), Journal Articles & Opinion Pieces IBFD; and M. Devereux & J. Vella, *Implications of Digitalization for International Corporate Tax Reform*, 46 Intertax 6/7, p. 555 (2018).

6. Note that all subsequent references to the OECD Model and Commentary refer to the version of the OECD Model Tax Convention on Income and on Capital as it read on 21 November 2017, unless otherwise provided.

7. *See also* sec. 1.1.1.

8. *See*, e.g. art. 159(1) Luxembourg Income Tax Law (*Loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu*) or sec. 1(1) German Corporate Income Tax Law (*Körperschaftsteuergesetz*). Many countries, such as Luxembourg and Germany, provide as an alternative criterion to constitute corporate tax residence the place of management. Even in cases where a company is considered resident by a state only if its place of (effective) management is located within the state's territory, it is simpler to locate central management meetings, involving a limited circle of persons, and other indicative factors of management within a given territory compared to moving major parts of a company's staff or physical production processes to a given state. *See also* E. Traversa, *Corporate Tax Residence at the Crossroads between International Competition and Convergence: Outlining the Debate*, in *Corporate Tax Residence and Mobility*, p. 17 et seq. (E. Traversa ed., IBFD 2018), Books IBFD; and Schön, *supra* n. 5, at p. 69 et seq.

9. Moreover, most highly digitalized business models rely heavily on intangibles, which allows them to benefit from specific tax regimes such as IP boxes. *See* OECD, *Addressing the Tax Challenges of the Digital Economy – Action 1: 2015 Final Report*, p. 90, paras. 223-224 (OECD 2015), Primary Sources IBFD [hereinafter *Action 1 Final Report*]; OECD, *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS*, p. 24, para. 34; p. 52, para. 135 et seq., pp. 101-102, para. 289 and pp. 110-111, paras. 321-324 (OECD 2018) [hereinafter *2018 OECD Report*]; and Becker, Englisch & Schanz, *supra* n. 2, at p. 309.

of business profit taxation potentially needs a redesign to fulfil its initial objective. This initial objective is to allow states to tax in case a company participates in their economic life by exercising its business activity by virtue of a certain fixed and permanent presence (constituting a PE).[10] The PE concept was intended to fulfil three main objectives: (i) the assignment of tax revenue to the source state; (ii) ensuring practicability by virtue of a certain minimum threshold and consequently avoiding source taxation in whatever state the business exercises its activity; and (iii) granting equal treatment and hence neutrality between different forms of secondary business establishment (i.e. resident companies).[11] The PE concept thereby "reconciles requirements of international justice (prerogative of source-based taxation) and practical prudence (prerogative of residence-based taxation)".[12] "International justice" in this respect should, in the author's opinion, be understood with reference to the first of the three above-mentioned objectives, which is to allow certain states in whose economic life a taxpayer actively participates to tax parts of income generated through said active participation. This book leaves further reflections about the concept of international tax justice between residence and source states aside, which has been sufficiently discussed in other works,[13] and focuses on the technical elaboration of the division of taxing rights between residence and destination states.

10. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 7*, para. 11 (21 Nov. 2017), Treaties & Models IBFD. *See also* F. Wassermeyer & C. Kaeser, *Art. 5 MA – Betriebstätte*, in *Doppelbesteuerung – Kommentar zu allen deutschen Doppelbesteuerungsabkommen*, m. no. 1 (150th ed., F. Wassermeyer et al. eds., C.H. Beck 2020); and E. Reimer, *Article 5 – Permanent Establishment*, in *Klaus Vogel on Double Taxation Conventions*, m. no. 2 (4th ed., E. Reimer & A. Rust eds., Wolters Kluwer 2015).

11. Reimer, id., at m. no. 3: The "neutrality" referred to by Reimer certainly does not cover the economic meanings of neutrality, such as investment neutrality or other sorts of neutralities, but rather refers to an equal tax treatment between different sorts of secondary business establishment. Even if such neutrality may be achieved by applying corporate tax to both incorporated business as well as establishments exercising their business activity in a given state, this does not imply that it is equally neutral from an economic point of view on neutralities.

12. Id.

13. *See*, e.g. P. Hongler, *Justice in International Tax Law: A Normative Review of the International Tax Regime* (IBFD 2019), Books IBFD; and M. Valta, *Das Internationale Steuerrecht zwischen Effizienz, Gerechtigkeit und Entwicklungshilfe* (Mohr Siebeck 2014). Hongler analyses fundamental principles of taxation as well as concrete rules of avoidance of double taxation with respect to their compatibility with the concept of justice according to different (political) philosophers. Valta develops standards based on the justification of taxation and the philosophy of John Rawls and combines these reflections with, inter alia, economic considerations, examining the tax treaty practice of developing and developed countries.

The technical issue to be resolved occurs not on the level of residence state taxation, but at the level of the concept defining a state as source state, which allows for the exercise of that state's jurisdiction to tax. Whereas one may suggest that the focus of any "digitalized taxation" reform discussion would focus on the PE threshold, which is today fundamental to the balancing of taxing rights between residence and source states, the current discussion about the international tax regime, however, turns out to reach significantly wider. In light of this development, the foundations of the international tax order, which distinguishes between residence and source state taxation, seem to be outdated, and the policy and scholarly discussions of today focus on issues similar to those that were already discussed 100 years ago when the current international tax order was established.[14] Whereas the initial discussion has resulted in a system in favour of a primary taxing right on business profits of the residence state and a limited taxing right of the source state,[15] the cards may be reshuffled today. This book aims to test whether destination-based corporate taxation (DBCT) rather than traditional residence and source-based taxation could provide one possible solution to the outcome of that card game; and if it generally does, how it must be designed more specifically in order to achieve that goal.[16]

1.1.1. Challenges of the digitalized economy

The OECD identified three features shared by digitalized business models that describe their very nature. The characteristics cause specific and concrete concerns with respect to tax law. It is not the objective of this book to contest these characteristics, instead they are considered throughout as a basic understanding of the nature of digitalized business models.

First, digitalized businesses benefit from a global reach of their activities irrespective of their physical location. The OECD refers to this feature as "cross-jurisdictional scale without mass" in its 2018 Report.[17] It describes

14. Bruins et al., *supra* n. 4. *See*, for the current discussion, e.g.: A. Báez Moreno, *A Note on Some Radical Alternatives to the Existing International Corporate Tax and Their Implications for the Digital(ized) Economy*, 46 Intertax 6/7, pp. 560 et seq. (2018); M. Devereux & J. Vella, *Taxing the Digitalised Economy: Targeted or System-Wide Reform?*, British Tax Review 4, pp. 387 et seq. (2018); S. Gadžo, *New Nexus for the Digital Economy: An Analysis of Digital, Revenue-Based and User-Based Factors*, in *Taxing the Digital Economy: The EU Proposals and Other Insights* p. 97 et seq. (P. Pistone & D. Weber eds., IBFD 2019), Books IBFD; and Devereux & Vella (2018), *supra* n. 5, at p. 550 et seq.
15. Arts. 7(1) and 5 OECD Model.
16. *See also* sec. 1.2.
17. OECD, *2018 OECD Report*, *supra* n. 9, at p. 51, para. 131 et seq.

the possibility to widely spread the production process across different countries and to reach out to more customers all over the world at the same time.[18] However, the OECD acknowledges that this is also "a function of globalisation more generally and … not unique to digitalized businesses".[19]

Second, digitalized businesses rely heavily upon intangible assets, including intellectual property (IP) rights. According to the 2018 OECD Report, "intangible assets can be an important driver of business value", which is why "the location in which a business' intangible assets are controlled/managed can therefore have a material impact on where that business' profits are subject to tax".[20] Again, the OECD emphasizes that the importance of exploiting intangible assets is not unique to value creation in digitalized businesses but becoming increasingly important in all sorts of other businesses as well.[21]

Third, the OECD highlights the increasing reliance on data and user participation, as well as their synergies with IP, as typical for digitalized businesses. The OECD emphasizes that the increasing and intensive use of data allows for significant improvements of products and services provided by digitalized businesses.[22] Furthermore, the active involvement of users in the value creation process of some businesses is unprecedented in its dimension.[23]

In addition to the OECD, other stakeholders also emphasize the specific importance of data and user participation as one of the main characteristics of digitalized business models.[24] Most of the latter, such as targeted online advertising, would not even work the way they do without user participation and the gathering, processing and analysis of user data by the digitalized business.[25] Moreover, some of these business models, such as online adver-

18. Id., at p. 51, para. 131.
19. Id., at p. 52, para. 134.
20. Id., at p. 52, para. 135.
21. Id., at p. 53, para. 138.
22. Id., at p. 53, para. 139 et seq.
23. Id., at p. 55, para. 145.
24. Id., at p. 53, para. 139 et seq.; FR: P. Collin & N. Colin, Ministère de l'Economie et des Finances/Ministère du Redressement productif, *Mission d'expertise sur la fiscalité de l'économie numérique*, p. 35 et seq. (2013); European Commission, Report of the Commission Expert Group on Taxation of the Digital Economy, pp. 12-13 (2014); OECD, *Action 1 Final Report*, *supra* n. 9, at p. 68, para. 164 et seq. and p. 102, para. 262 et seq.; and European Parliament, *Tax Challenges in the Digital Economy – Study for the TAXE 2 Committee*, pp. 14 and 17 (2016). Related activities regarding data and user participation are also referred to as "data-driven activities" in the rest of the book.
25. Online advertising can be targeted only because the target groups are predefined by virtue of data collection and processing of users. Thus, it is often combined with another type of service that incites users to divulge information, such as social networks

tising, are not only linked to the location of users for data collection activities, but also take into account the location of such users for the effective functioning of the service, i.e. the display of the advertising. For instance, targeted online advertising only works in places where users are located whose data were collected and processed in the first place, since only in that place can the publishing company also target users based on the data previously collected.[26] Consequently, it has been suggested that such an important factor in the production or service provision value chain would justify taxation of the business profits in the jurisdiction where such data-driven activities take place.[27]

Aiming at a better understanding of economic value creation within data-driven business activities, the OECD identifies five steps in the so-called data value cycle:[28] (i) data origination; (ii) data collection leading to large datasets also known as "big data"; (iii) data analytics; (iv) knowledge base; and (v) data-driven decision-making.[29] These five steps of the data value

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or search engines. If users did not actively or passively contribute to that data collection, e.g. by sharing data themselves or just by surfing the web, allowing for a tracking of their preferences by so-called cookies, companies would not be able to form and distinguish target groups. In a second step, they could still of course offer advertising space to advertisers, but such space would not be any more beneficial than an advertising pillar in a city centre, for example. *See also* OECD, *2018 OECD Report*, *supra* n. 9, at pp. 44-45, paras. 104-106; and pp. 54-55, para. 144.

26. J. Becker & J. Englisch, *Ausgleichsteuer: Wie die EU-Finanzminister einen Pflock ins Neuland rammen wollen*, Makronom (2 Oct. 2017), available at https://makronom.de/google-tax-ausgleichsteuer-wie-die-eu-finanzminister-einen-pflock-ins-neuland-rammen-wollen-23141 (accessed 28 Dec. 2017). Of course, companies may draw economically valuable information also in respect of other groups of users located in other jurisdictions from data collected in one jurisdiction.

27. *See*, e.g. Becker, Englisch & Schanz, *supra* n. 2; and Y. Brauner & P. Pistone, *Adapting Current International Taxation to New Business Models: Two Proposals for the European Union*, 71 Bull. Intl. Taxn. 12, p. 683 (2017), Journal Articles & Opinion Pieces IBFD.

28. *See also* the related concept of "datafication" of business-relevant processes, as described by the OECD in OECD, *OECD Digital Economy Outlook 2017*, p. 205 (OECD 2017).

29. OECD, *2018 OECD Report*, *supra* n. 9, at pp. 53-54, para. 142: Data origination describes the generation of digital data, such as transactions, user behaviour tracking through cookies or user-generated content. Data collection leading to "big data" describes the process of collecting data that in the next step, data analytics, will be processed and analysed. Note that data origination sources, e.g. users, may be located in a different place than the large dataset or database. The fourth step, knowledge base, describes the basis for the economic value drawn from the previous steps, which is the accumulated knowledge through data collection and processing. The knowledge base can be automatically updated on a continuous basis, e.g. through artificial intelligence (AI) or machine-learning processes. The last step, data-driven decision-making, is the result of the previous step, which is informed decision-making on the level of the company based on the collected, analysed and accumulated data knowledge.

cycle do not necessarily have to be located in the same place; especially the data collection, data analytics and data-driven decision-making can well be located in three different countries. Moreover, all five steps are interdependent for the maximization of economic value in the hands of the digitalized business.[30] This characterization seems appropriate and is not contested within this book. The OECD further distinguishes between active and passive user participation.[31] For the purposes of this book, data is defined in a broad sense as any piece or unit of information.[32] Throughout this book, the notion should not be read in its technical, computer science sense, i.e. as a sequence of symbols.

From these observations, one may infer that the role of users, their data and participation is in many cases different from the role of customers before digitalization.[33] Users not only deliver resources essential to the functioning of digitalized services and business activities, but their mere presence already has a beneficial effect on the company,[34] since it creates network effects and incites more users to use the specific digitalized service. These network effects are not entirely new to digitalized business models but are already known from telephone and fax networks, just as multi-sided markets also already existed before digitalization.[35] However, compared to customers in earlier or entirely offline business models, users seem to increase the company's visibility and popularity even more in the digitalized economy and thereby its revenues, since these new users deliver valuable data to the company. Whether it is justified to attribute a more important role to users

30. *See also* id., at p. 53, para. 142: "[...] this process can be described as a value cycle involving several interconnected phases [...] ."
31. Id., at pp. 55-56, paras. 147-149. *See also* sec. 2.3.2.1.3.
32. *See also* sec. 2.3.2.1.2.
33. European Commission, Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, COM(2018) 148 final, p. 7 (21 Mar. 2018); and UK: Her Majesty's Treasury, *Corporate tax and the digital economy: position paper update*, paras. 2.5 et seq. and 2.26 et seq. (2018). Critically, *see* Devereux & Vella, *Taxing the Digitalised Economy*, *supra* n. 14, at p. 396.
34. Think of highly active users in a social network that not only disclose a higher number of relevant information for advertising purposes than inactive or passive users but also incite other users to join the network since such accession allows them to see the active users' content that can be of interest to passive users for one or the other reason. These other, passive users, incited to join the network due to the activity of more active users, allow the social network to track their online behaviour and preferences, which in turn raises the network's ability to sell targeted advertising space and hence its revenues.
35. The OECD cites the example of television and newspaper advertisements that also constituted multi-sided markets, with advertisers, an audience or readership and the advertising platform that is television or the newspaper: OECD, *2018 OECD Report*, *supra* n. 9, at p. 28, para. 48.

compared to consumers in taxation is debatable, especially since it would be difficult, if not impossible, to draw a dividing line between situations where such a destination state[36] contributes "as much" that it would justify taxation by this state and situations where a destination state does not contribute "enough" to create such taxing right.[37] Consequently, these considerations should be reflected in any potential nexus rule, and the distinction between users and consumers for justifying taxable nexus should be critically questioned, depending on the rationale of any tax proposal.

All of these observations and key features worked out by the OECD can be summed up under a common heading: intangibility. This encompasses also the lack of multi-layered physical production steps that is inherent to the very nature of digitalized business models.[38] Moreover, a digitalized service provision is not necessarily remunerated in a linear manner between service provider and service recipient for a given service, as shown by the example of online advertising.[39] In this sense, it is rather common to "cross-subsidize" free service provisions to one group of service recipients by payments of another group of service recipients (which does not necessarily mean that these groups are mutually exclusive; one natural or legal person can obtain different services from one single provider and therefore be part of both groups).

Furthermore, digitalization reinforces other challenges to the international tax system, which are profit shifting and a "race to the bottom" regarding tax rates.[40] This "race to the bottom" constitutes one of the key challenges of international tax competition, where governments try to attract mobile taxpayers to locate their residence or activity or investment within their territory by lowering the tax rate or diminishing the tax base.[41] The ultimate aim of governments remains to increase the state welfare or government budget, since raising the tax rates and extending the tax base would primarily

36. The state, which is supposed to tax under the new tax measures, may be described in general as "destination state", which can be either the state of the users ("user state") or customers ("market state"). For a delimitation of these terms, *see* sec. 2.3.2.2.1.
37. *See also* Devereux & Vella, *supra* n. 14, at p. 396.
38. For further and more detailed information on specific digitalized business models, *see* ch. 3.
39. OECD, *2018 OECD Report*, *supra* n. 9, at p. 55, para. 141. For further explanations, *see* sec. 1.1.2.
40. Devereux & Vella, *supra* n. 14, at pp. 403-404.
41. *See*, e.g. Schön, *supra* n. 5, at p. 70 et seq. For a critical view on the negative effects of such a "race to the bottom" in income taxation, *see* Graetz, *supra* n. 5, at p. 283.

incite resident taxpayers or active businesses to relocate their residence/ activity rather than attaining the targeted objective.[42]

The topic is highly political, which is why the following paragraphs elaborate on the state of the political debate on the issues explained above.[43] Repeated mantras in finding political solutions to the tax challenges of the digitalized economy aim at submitting companies to "fair taxation",[44] having digital companies paying "their fair share of taxes"[45] and avoiding "ring-fencing" of the digitalized economy.[46] At the same time, the international community of states initially did not seem eager to operate significant changes to the current international tax order, as noted by the sobering results of the 2015 OECD Action 1 Final Report[47] and the 2018

42. Schön, *supra* n. 5, at p. 70.

43. For a more detailed overview of the development of political discussions, *see also* J. Sinnig, *Update Internationales und Europäisches Steuerrecht*, in *Tagungsband DSRI-Herbstakademie 2020: Den Wandel begleiten - IT-rechtliche Herausforderungen der Digitalisierung* (J. Taeger ed., OlWIR 2020); J.M. Schmittmann & J. Sinnig, *Aktuelle Entwicklungen im Steuerrecht in der Informationstechnologie 2018/2019*, 23 Kommunikation und Recht 2 (2020); J. Sinnig, *Update Internationales und Europäisches Steuerrecht*, in *Tagungsband Herbstakademie 2019: Die Macht der Daten und der Algorithmen - Regulierung von IT, IoT und KI* (J. Taeger ed., OlWIR 2019); J.M. Schmittmann & J. Sinnig, *Aktuelle Entwicklungen im Steuerrecht in der Informationstechnologie 2017/2018*, 22 Kommunikation und Recht 2 (2019); and J. Sinnig, *Internationale Besteuerung der digitalen Wirtschaft: EU- und OECD Vorschläge*, in *Tagungsband Herbstakademie 2018: Rechtsfragen digitaler Transformationen – Gestaltung digitaler Veränderungsprozesse durch Recht* (J. Taeger ed., OlWIR 2018).

44. *See*, e.g. OECD, *Electronic Commerce: Taxation Framework Conditions*, Report by the Committee on Fiscal Affairs, presented to ministers at OECD Ministerial Conference on "A Borderless World: Realising the Potential of Electronic Commerce", p. 4, para. 9 (8 Oct. 1998); EU2017EE, *Prime Minister Jüri Ratas discussed the fair taxation of digital economy with Commissioner Pierre Moscovici*, available at https://news.err.ee/618861/ratas-commissioner-moscovici-discuss-fair-taxation-of-digital-economy (accessed 22 Feb. 2022); and G. Kofler & J. Sinnig, *Equalization Taxes and the EU's "Digital Services Tax"*, 47 Intertax 2, pp. 3 and 8-9 (2019).

45. OECD, *Action 1 Final Report*, *supra* n. 9, at p. 16, para. 4; European Commission, Communication from the Commission to the European Parliament and the Council: *A Fair and Efficient Tax System in the European Union for the Digital Single Market*, 21 Sept. 2017, COM(2017) 547 final, p. 8; and Kofler & Sinnig, id., at p. 3.

46. OECD, *Action 1 Final Report*, *supra* n. 9, at p. 54, para. 115; OECD, *2018 OECD Report*, *supra* n. 9, at p. 167, para. 375; B. Westberg, *Taxation of the Digital Economy: An EU Perspective*, 54 Eur. Taxn. 12, p. 541 (2014), Journal Articles & Opinion Pieces IBFD; European Commission, *Report of the Commission Expert Group on Taxation of the Digital Economy*, p. 5 (2014); and J. Li, *Protecting the Tax Base in the Digital Economy*, Papers on Selected Topics in Protecting the Tax Base of Developing Countries, Paper no. 9, p. 38 (2014), available at http://www.un.org/esa/ffd/wp-content/uploads/2014/10/20140604_Paper9_Li.pdf (accessed 30 Oct. 2020). *Contra* F. Vanistendael, *The Level Playing Field in Digital Taxation*, 90 Tax Notes International, p. 870 (2018).

47. OECD, *Action 1 Final Report*, *supra* n. 9, at p. 106, paras. 273 et seq. and p. 148, para. 383 et seq.

OECD Interim Report.[48] Whereas terms such as "fairness" or "tax justice" are vague, it appears reasonable to avoid ring-fencing some business activities compared to others, leading to the same category of taxable profits, which are business profits (as now dealt with by article 7 of the OECD Model). This is also justified for the sake of equal treatment of comparable circumstances, which is given in the case of digital and non-digital activities, since it is not only difficult in practice to draw a clear line between digitalized and non-digitalized businesses but also not justified based on any rationale respecting existing international tax principles. However, if the non-ring-fencing of certain types of activities is the principal aim of tax reform, this would also entail a broader reform of the current tax system, which does not allow enough leeway to include digitalized business models in the "physical presence distinction" as provided by articles 7(1) and 5 of the OECD Model.

By 2019, initial hesitation to adjust tax rules has diminished and government officials and tax experts are now working at the level of the OECD on a tax solution capable of creating global consensus on how to deal with tax issues in the digitalized economy. In the fall of 2019, a second invitation for public comments (public consultation) was launched. At the outset of the public consultation, the OECD published a document titled "Secretariat Proposal for a 'Unified Approach' under Pillar One".[49] The proposal presents a potential solution based on the foregoing negotiations and interim results of the year 2019. These results are notably a "Programme of Work", resulting from a first public consultation in early 2019.[50] The latter documents suggest a two-pillar structure, distinguishing between nexus and profit allocation rules (Pillar One) and a global anti-base erosion proposal ensuring a minimum taxation (Pillar Two).[51] Whereas the first public consultation document still proposed three alternative solutions, named "user participation proposal", "marketing intangibles proposal" and "significant

48. OECD, *2018 OECD Report*, *supra* n. 9, at pp. 212-213, paras. 512-514, criticized by Vanistendael, *supra* n. 46, at p. 867 as concluding nothing more than has already been concluded in the 1998 OECD Ottawa Ministerial Report. *See also* Y. Brauner, *Taxing the Digital Economy Post-BEPS, Seriously*, 46 Intertax 6/7, p. 462 (2018).
49. OECD, *Public Consultation Document: Secretariat Proposal for a "Unified Approach" under Pillar One* (OECD 2019) [hereinafter *Second Public Consultation Document*].
50. OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy* (OECD 2019) [hereinafter *Programme of Work*]. *See also* OECD, *Public Consultation Document: Addressing the Tax Challenges of the Digitalisation of the Economy* (OECD 2019) [hereinafter *First Public Consultation Document*]; and OECD, *Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note* (23 Jan. 2019).
51. OECD, *Programme of Work*, id., at pp. 9-33.

economic presence proposal",[52] the "Unified Approach" combines the common characteristics of all of these three proposals and suggests not only the taxation of highly digitalized but also other consumer-facing businesses in the user/market jurisdiction,[53] based on a taxable nexus constituted by sales.[54] The proposal varies from the current PE concept in that it would allow a state to tax even though the company does not maintain a physical presence in that state.[55] This new rule would be introduced as a stand-alone treaty provision rather than as an amendment to article 5 or 7 of the OECD Model.[56] To be practically feasible, the OECD suggests the proposal should include thresholds, such as revenue, evidencing a "sustained and significant involvement in the economy of a market jurisdiction".[57] Furthermore, the proposal mentions profit allocation rules generally based on the arm's length standard but going beyond this principle by applying formulary apportion-

52. Id., at p. 11, para. 22; OECD, *First Public Consultation Document*, *supra* n. 50, at p. 9, para. 17 et seq., p. 11, para. 29 et seq. and p. 16, para. 50 et seq. The "user participation" proposal relies upon the value created through the development of an active and engaged user base and would apply only to a limited number of business models that are social media platforms, search engines and online marketplaces. Parts of the profits of a digital company falling within the scope of this proposal would be taxed in the user jurisdiction on the basis of a non-routine or residual profit split approach. The "marketing intangibles" proposal, applying not only to the limited amount of business models like the "user participation" proposal, but to all sorts of MNEs, suggests allowing a jurisdiction to exercise its taxing rights when the company "reaches into" its territory to create a user or customer base and other marketing intangibles. Physical presence can be possible, but is not strictly required. Marketing intangibles are, for example, the brand name but also the reflection of such attributes in the minds of customers, which is why they are linked to the country of customers. Parts of the profits of the company would be attributed under a non-routine or residual profit split method. The "significant economic presence" proposal deals with an extended PE definition that would catch non-physical, digital factors in a given jurisdiction, such as the existence of a user base, a certain amount of digital content produced in that jurisdiction or local language and payment options. Profits could be attributed under a fractional apportionment method (taking into account sales, assets, employees and users) or a deemed profits method. The OECD suggests the application of a WHT mechanism to facilitate tax collection.

53. Note that this terminology of "user/market jurisdiction" has been retained in OECD documents from 2019, *see*, e.g. OECD, *Second Public Consultation Document*, *supra* n. 49, at p. 5, para. 12. In the more recent statement of 2020, the OECD refers to the "market jurisdiction" rather than the state of "destination" or "users". The OECD highlights here, however, that the market jurisdiction may also be the state of location of users, *see* OECD, *Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy, approved by the OECD/G20 Inclusive Framework on BEPS on 29-30 January 2020*, p. 8, para. 10 (OECD 2020) [hereinafter *Statement on the Two-Pillar Approach*].

54. OECD, *Second Public Consultation Document*, *supra* n. 49, at p. 4, para. 10, p. 5, para. 15 and p. 7, paras. 19-20.

55. Id., at p. 6, para. 16.

56. Id., at p. 5, para. 15 and p. 8, para. 22.

57. Id., at p. 8, para. 22.

ment where appropriate.[58] At the heart of the proposal lies a new three-tier mechanism, distinguishing three "categories" of profits based on different types of business activities and functions. Within each tier, existing or amended profit attribution rules would apply and allocate profits to one or more jurisdictions.[59]

In early 2020, the OECD published a statement outlining more concretely the design of the "Unified Approach" and containing a revised programme of work envisaging further steps to be undertaken.[60] The statement also contains sections on the elimination of double taxation, tax certainty and dispute resolution mechanisms, as well as general tax administrative considerations. Regarding profit attribution between different states, the OECD refines the above-mentioned three-tier mechanism, distinguishing three amounts A, B and C.[61] Furthermore, the new nexus rule, on which the taxation of amount A is based, is explained in more detail. The OECD suggests that the scope of the new market state taxing right should include not only automated digital services provided on a standardized basis to a large number of customers or users in different states but also other consumer-facing businesses.[62] Consumer-facing businesses are defined as "businesses that generate revenue from the sale of goods and services of a type commonly sold to consumers, i.e. individuals that are purchasing items for personal use and not for commercial and professional purposes".[63] Some businesses should be explicitly excluded from the broad scope of application, such as extractive industries and producers and sellers of raw materials and commodities.[64] The new rule should also maintain a number of thresholds, such as a general revenue threshold, an in-scope activity revenue threshold and a *de minimis* rule.[65] The OECD maintains the idea of the new taxing right

58. Id., at p. 5, para. 15 and p. 6, para. 18.
59. Id., at p. 9, para. 30.
60. OECD, *Statement on the Two-Pillar Approach*, *supra* n. 53.
61. Amount A, creating a new taxing right, consists of a share of residual profit allocated to market jurisdictions based on a formula, irrespective of physical presence maintained in these jurisdictions. Amount B represents a fixed remuneration based on the arm's length standard for defined baseline distribution and marketing functions taking place in the market jurisdiction. Amount C contains any additional profit attributable to distribution and marketing activities exceeding amount B. Id., at p. 8, paras. 10-11.
62. Id., at pp. 10-11, paras. 22-29.
63. Id., at p. 11, para. 24. In para. 28, the OECD lists some examples, such as personal computing products (e.g. software or mobile phones), clothes, cosmetics, luxury goods and branded foods.
64. Id., at p. 11, para. 30.
65. Id., at p. 12, para. 35.

nexus being based on indicators of a significant and sustained engagement with market jurisdictions.[66]

In autumn 2020, the OECD published a so-called blueprint for its Pillar One, which was accompanied by the launch of a third public consultation procedure inviting for input from October to December 2020 with a view to further developing the concepts presented in the blueprint and answering the remaining questions in that respect.[67] The targeted agreement on a consensus-based solution amongst the different participating states had been postponed to the middle of 2021.[68] In essence, the blueprint develops and substantiates the draft design options contained in the OECD's Statement from January 2020, specifically with respect to the amounts A, B and C that confer a taxing right to market jurisdictions, which can in some business models also be user jurisdictions.[69] The blueprint decides to abandon the amount C that has been much criticised for its vagueness. Moreover, the document highlights eleven topics on which political decisions are needed for advancing in the technical solution.[70] Notably, no political agreement has been reached so far on the categories of covered activities (automated digital services and consumer-facing businesses).[71] However, the blueprint delivers detailed considerations about the practical application of the concepts as they are currently developed by discussing the application of these concepts to specific business models.[72] In that respect, the OECD also suggests not only providing a general definition of automated digital services but completing this definition with lists of covered and excluded services.[73] When applying the new taxing rights, one should therefore check the two lists as a first step, and only where the concerned service is not enumerated in either list, it should be checked against the general definition.[74] Moreover, the OECD stated that the new taxing right, amount A, will include a revenue threshold combining the worldwide revenues with relevant in-country in-scope revenues of the taxpayers concerned.[75] In order to facilitate the administration of this new taxing right, the OECD suggests implementing a stag-

66. Id., at p. 12, para. 36.
67. OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint* (OECD 2020); and OECD, *Public Consultation Document: Reports on the Pillar One and Pillar Two Blueprints* (OECD 2020).
68. OECD, *Report on Pillar One Blueprint*, id., at p. 9.
69. Id., at p. 11, paras. 6-7.
70. Id., at p. 12, para. 8.
71. Id., at p. 12, para. 8 and p. 19, para. 23.
72. Id., at p. 22, paras. 38 et seq.
73. Id., at p. 19, para. 25 et seq.
74. Id., at pp. 19-20, paras. 25-28.
75. Id., at p. 58, para. 171 et seq.

gered approach, beginning with higher thresholds that are gradually reduced to increase the amount of business covered once the tax administrations are able to cope with their new tasks.[76] It is as yet uncertain whether the new taxing right also applies a temporal requirement in order to "avoid covering isolated or one-off transactions that might not demonstrate a sustained engagement with a market".[77] Also other design features, such as a loss carry-forward regime and safe harbours for businesses already taxed in the market jurisdiction in accordance with the existing arm's length standard, are discussed in more detail in this blueprint.[78] The OECD maintains the idea to exclude certain industries from the new taxing right, such as natural resources, financial services, construction, sale and leasing of residential property and international airline and shipping businesses.[79]

Preceding the most recent developments at the OECD level, a number of different concepts have been proposed throughout the scholarly literature and national, regional and early international policy documents to face issues in the tax rules applying to digitalized businesses.[80] Whereas a number of countries adopted or are about to adopt so-called interim measures, mostly sector-specific, turnover and user jurisdiction-based levies,[81] other proposals include the modification of the PE concept towards an inclusion of

76. Id., at p. 13.
77. Id., at p. 65, para. 196.
78. Id., at p. 14.
79. Id., at p. 47, para. 105.
80. *See*, e.g. A.J. Cockfield, *Reforming the Permanent Establishment Principle Through a Quantitative Economic Presence Test*, 38 Canadian Business Law Journal (2003); Y. Brauner & A. Báez Moreno, *Withholding Taxes in the Service of BEPS Action 1: Address the Tax Challenges of the Digital Economy*, IBFD White Paper (2015), Journal Articles & Opinion Pieces IBFD; Becker, Englisch & Schanz, *supra* n. 2; European Commission, Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, COM(2018) 147 final (21 Mar. 2018); European Commission, Commission Recommendation of 21 March 2018 relating to the corporate taxation of a significant digital presence, C(2018) 1650 final (2018); and OECD, *Action 1 Final Report*, *supra* n. 9, at p. 107, para. 277 et seq. (significant economic presence), p. 113, para. 292 et seq. (withholding tax on digital transactions) and p. 115, para. 302 et seq. (equalization levies). Proposal COM(2018) 148 is hereinafter referred to as the "DST Proposal", and proposal COM(2018) 147 is hereinafter referred to as the "SDP Proposal".
81. UK: HM Treasury, *Introduction of the new Digital Services Tax* (11 July 2019), available at https://www.gov.uk/government/publications/introduction-of-the-new-digital-services-tax (accessed 12 Nov. 2019); Explanatory Statement to the DST proposal; and FR: *Loi n° 2019-759 du 24 juillet 2019 portant création d'une taxe sur les services numériques et modification de la trajectoire de baisse de l'impôt sur les sociétés, JORF n°0171 du 25 juillet 2019* [Law no. 2019-759 of 24 July 2019 creating a digital services tax and modifying the path of reducing corporate tax].

so-called digital or virtual PEs or significant digital or economic presence.[82] Concretely, the European Commission proposed on 21 March 2018 two directives introducing a digital services tax (DST) as an interim solution and the concept of "significant digital presence" as a long-term modification of Member States' PE concept. Almost one year after the proposals, a compromise on the digital services tax has been rejected by the Council of Ministers in favour of negotiating a long-term tax measure at the level of the OECD/Inclusive Framework.[83]

The pending political debate on the topic evidences the difficulties of finding a "simple" solution that would modify and adapt well within the existing tax system. The initial aims of the political discourse, fair and non-ring-fencing taxation of digitalized activities, seem difficult to reconcile with both the current international tax order and the new economic reality.

1.1.2. Tax concerns triggered by digital activities

Regarding the first and third attributes of digital activities, which the OECD describes as "cross-jurisdictional scale without mass"[84] and "increasing reliance on data and user participation",[85] the concerns raised by taxing such activities are twofold. First, no physical presence of the business engaging in tax-relevant activities is detectable, although the business clearly participates in the economic life of a (potential source) state, since this state's residents and nationals consume services provided by digitalized companies.[86] The aim of the PE concept was initially to allow those states to tax

82. Significant economic presence, significant digital presence, digital PEs and virtual PEs envisage a comparable concept, which is why these terms are used in a synonymous manner in this book. *See*, e.g. SDP Proposal; and OECD, *Action 1 Final Report*, *supra* n. 9, at p. 107, para. 277 et seq.
83. For further criticism of this proposal, *see also* CFE Tax Advisers Europe, Opinion Statement FC 1/2018 on the European Commission proposal of 21 March 2018 for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, p. 5 (2018), available at http://taxadviserseurope.org/wp-content/uploads/2018/06/CFE-Opinion-Statement-EU-Digital-Services-Tax.pdf (accessed 11 July 2018); D. Pinto, *Exclusive Source or Residence-Based Taxation: Is a New and Simpler World Tax Order Possible?*, 61 Bull. Intl. Taxn. 7, p. 291 (2007), Journal Articles & Opinion Pieces IBFD; D. Hohenwarter et al., *Qualification of the Digital Services Tax Under Tax Treaties*, 47 Intertax 2 (2019); and Kofler & Sinnig, *supra* n. 44.
84. OECD, *2018 OECD Report*, *supra* n. 9, at p. 51, para. 130 et seq. *See also* sec. 1.1.1.
85. Id., at p. 53, para. 139 et seq. *See also* sec. 1.1.1.
86. This tax challenge has also been subject to the US Supreme Court's decision in US: Supreme Court, 21 June 2018, *South Dakota v. Wayfair, Inc.*, Case no. 138 S. Ct. 2080. Core of the discussion was the retail tax of South Dakota on the provision of goods and services within the state, which obliges consumers to collect the sales tax where

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