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Building on the Rubble of Pillar One

In this article, the author argues that Pillar One is crumbling before our eyes, but it might yet produce lasting, unexpected and welcome results if it establishes the group as one tax entity and brings to an end the sophistry of arm's length pricing.

1. Introduction

This article is about Pillar One, a project of the OECD/G20 Inclusive Framework that foreshadowed serious inroads into several fundamental doctrines of international tax law previously thought impervious to change. In the process, it promised to address some of the legitimate grievances of the developing world regarding the systemic shortcomings in the current rules and deliver fairer and more coherent outcomes from cross-border trade and investment. That makes Pillar One a much more ambitious project than Pillar Two, which is, in large part, tweaking and buttressing the design of domestic CFC rules, rules we have been familiar with for 60 years. It also makes Pillar One an ideal topic for a collection of articles looking back and looking ahead at the rules of international tax.

Unhappily, while Pillar One could have been revolutionary, the ambition is slowly eroding. Of course, this assessment is not shared by the finance ministers[1] and leaders[2] of the G7 countries, the finance ministers of the G20 countries[3] or most of the countries in the OECD's Inclusive Framework,[4] who have been congratulating themselves on landing a project that reconstructs pivotal rules of international tax. But given the persistent downward trajectory documented in this article, it is unlikely this gloomy situation can be remedied by the time the project is scheduled to commence in 2023.[5]

Having said that, the argument of this article is that Pillar One is both a failure and success. For reasons that will be discussed, it should have a lasting and far-reaching legacy, just not the one it was aiming for. The effects will be seen in the heirs of Pillar One as they emerge.

2. The Ambition of Pillar One

This article focuses on the part of Pillar One that deals with giving jurisdictions where customers are located greater taxing rights over the profits of multinational enterprises (MNEs) – Amount A. But it is worth taking a small detour though the other element of Pillar One – Amount B. Amount B proposes "a fixed remuneration for baseline marketing and distribution functions that take place in the market jurisdiction"[6] driven in large part by the concerns of the developing world. It says much about the arm's length transfer pricing edifice that something as mundane as humans selling widgets from a shop should provoke, "[a] large number of tax disputes related to distribution functions",[7] and that the solution is to cut the Gordian knot, and set:

> fixed remunerations... reflecting an assumed baseline activity [to] provide certainty to both taxpayers and tax administrations, and reduce the dissatisfaction with the current transfer pricing rules.[8]

The two components of Pillar One can be thought of as reflecting the differing perspectives of the participants in the Inclusive Framework on what is wrong with the current rules of international tax. Amount A began as a solution for problems of the digital era, where substantial sales can be made in a country without needing a physical presence. Amount B is a solution to problems of the old-fashioned tangible world, where a physical presence

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1. G7 Finance Ministers, Communiqué, G7 Finance Ministers Agree Historic Global Tax Agreement (G7 2021), available at www.g7uk.org/g7-finance-ministers-agree-historic-global-tax-agreement/ (accessed 25 Aug. 2021), which states that: "we strongly support the efforts underway through the G20/OECD Inclusive Framework … We commit to reaching an equitable solution on the allocation of taxing rights, with market countries awarded taxing rights on at least 20% of profit exceeding a 10% margin for the largest and most profitable multinational enterprises. We will provide for appropriate coordination between the application of the new international tax rules and the removal of all Digital Services Taxes, and other relevant similar measures, on all companies …"
2. G7 Leaders, Carbis Bay Summit Communiqué, Our Shared Agenda for Global Action to Build Back Better (G7 2021), available at www.g7uk.org/wp-content/uploads/2021/06/Carbis-Bay-G7-Summit-Communique-PDF-430KB-25-pages-3.pdf (accessed 25 Aug. 2021).
3. G20, Third Finance Ministers and Central Bank Governors Meeting, Communiqué: Third Finance Ministers and Central Bank Governors Meeting, Venice, July 10, 2021 (G20 2021), available at www.g20.utoronto.ca/2021/210710-finance.html (accessed 25 Aug. 2021)
4. OECD, *Media Release, 130 countries and jurisdictions join bold new framework for international tax reform* (OCED 2021) [hereinafter the *2021 Media Release*], available at www.oecd.org/tax/beps/130-countries-and-jurisdictions-join-bold-new-framework-for-international-tax-reform.htm (accessed 25 Aug. 2021) and OECD, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy* (OECD 2021) OECD/G20, Base Erosion and Profit Shifting Project [hereinafter the *2021 Statement*], available at www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf (accessed 25 Aug. 2021).
5. *See*, for example, A. Fedan, *Case Study Analysis of the OECD Pillar One and Pillar Two Allocations to Developing Countries*, 75 Bull. Intl. Taxn. 8, sec. 4.4. (2021), Journal Articles & Opinion Pieces IBFD, who states that: "an adequate and robust mechanism to ensure that the economic activity of the operations of MNEs in developing countries are taxed accordingly is absent from the Two Pillars proposal, and the components that take actual economic activity into account do it only for large consumer markets in Amount A, which is irrelevant to most developing countries".
6. OECD, *Public Consultation Document – Secretariat Proposal for a "Unified Approach" under Pillar One* p. 6 (OECD 2019) [hereinafter the *Secretariat Proposal*].
7. Id., at p. 9.
8. Id.

exists, but the profits to be ascribed to it cannot be agreed.[9] Amount A reflects Europe's concern about the ability of US "big tech" to sell directly to 300 million wealthy European customers. Amount B reflects the developing world's concern about the tangible world where the local revenue authorities are no longer willing to address transfer pricing disputes through the arcane concepts and implausible methodology they are expected to apply under the OECD Transfer Pricing Guidelines[10] or the United Nations Practical Manual on Transfer Pricing for Developing Countries.[11] The developing world has an understandable affection for observable amounts, such as central bank lending rates or spot prices in commodities markets. Amount B is in this vein, but, as there is no external, observable, market-determined price, it is time to come up with an external, observable, government-determined price. Many amounts in tax law are arbitrary – from *de minimis* thresholds to thin capitalization ratios to effective lives of assets to *per diem* travel allowances. There is nothing new or untoward in seeking certainty at the cost of precision, especially where the claimed precision is fatuous.

Returning to Amount A, the media release from the Inclusive Framework in July 2021 claims Pillar One will reallocate "taxing rights on more than USD 100 billion of profit", a feat to be accomplished by:

> [re-allocating] some taxing rights over MNEs from their home countries to the markets where they have business activities and earn profits, regardless of whether firms have a physical presence there.[12]

The drafters of this document clearly thought the eye-catching story was the amount of money at stake. However, for the tax community, the breath-taking aspect is just how much of the architecture of the international tax order the Inclusive Framework was willing to jettison. There are three aspects to this action:

(1) Amount A abandons the permanent establishment (PE) threshold by permitting a market country to impose tax on the business profits of a non-resident company "regardless of whether firms have a physical presence there".[13]

(2) The separate entity concept is abandoned by giving the new taxing rights to the market country using "profit calculated at an MNE group or segment level".[14] Accordingly, market jurisdictions would no longer be limited just to taxing the profits of the individual branches and the subsidiaries of a multi-national group formed in, or operating in, the country.

(3) The arm's length pricing mantra is abandoned. The rights of the market jurisdiction would be determined by formulary apportionment, and not arm's length pricing. The tax base available to be divided between market countries would be, "determined by reference to [group worldwide] financial accounting income, with a small number of adjustments" with the share of each market jurisdiction being, "allocated to market jurisdictions with nexus using a revenue-based allocation key".[15]

And those departures are in addition to Amount B, which jettisons arm's length pricing in favour of arbitrary pricing of marketing and distribution functions.[16]

The significance of what was being discussed was not lost on the members of the Inclusive Framework. As early as January 2019 they acknowledged that:

> these proposals would lead to solutions that go beyond the arm's length principle. They also go beyond the limitations on taxing rights determined by reference to a physical presence generally accepted as another corner stone of the current rules.[17]

The ambition of these changes can be seen if one thinks about the real-world outcomes of the current orthodoxy. First, in many market jurisdictions, especially in the developing world, the local branch or subsidiary often performs little more than marketing and distribution activities for finished products. By design, the local presence employs few people who perform relatively mundane selling tasks, the local presence needs (and so owns) only minimal equipment and premises, and it bears little inventory, currency or warranty risk, all of which can be more or less easily re-located by contract. In this scenario, the tax base in the country would likely be limited to a markup on entity's expenses though the application of the resale price method, which the OECD says is, "probably most useful where it is applied to marketing operations".[18] The OECD Transfer Pricing Guidelines allocate to the local presence "the amount out of which the reseller would seek to cover its selling and other operating expenses and... make an

9. OECD, *Tax Challenges Arising from Digitalisation – Economic Impact Assessment* p. 16 (OECD 2020) [hereinafter the *Economic Impact Assessment*], where it is stated that: "Amount B is expected to reduce administration costs for governments and increase tax certainty for taxpayers, and may be of particular benefit to jurisdictions with low administrative capacity. Where the fixed return for baseline and marketing functions exceeds current returns taxable in market jurisdictions, Amount B would contribute to additional revenues in those jurisdictions. A number of jurisdictions with low administrative capacity assess that this is likely to be the case in their jurisdiction, as a result of the challenges they face applying the existing transfer pricing rules effectively. However, at the global level, the revenue effect of Amount B is likely to be modest, as it does not provide market jurisdictions with a new taxing right, but is merely designed to simplify the administration of the current transfer pricing system."
10. OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2017), Primary Sources IBFD [hereinafter the *Transfer Pricing Guidelines*].
11. UN, *United Nations Practical Manual on Transfer Pricing for Developing Countries* (UN 2021).
12. OECD, *2021 Media Release*, *supra* n. 4.
13. Id.
14. OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint* p. 11 (OECD 2020) [hereinafter the *Pillar One Blueprint*].
15. OECD, *2021 Statement*, *supra* n. 4, at p. 2.
16. OECD, *Pillar One Blueprint*, *supra* n. 14, at pp. 15-16, which states that the Inclusive Framework tried to insist that: "Amount B is intended to deliver a result that approximates results determined in accordance with the ALP". However, there is little doubt this part of Pillar One is all about coming up with an agreed, certain, but most definitely, arbitrary figure, and abandoning any pretence at reaching that number using the methods prescribed in the OECD *Transfer Pricing Guidelines*."
17. OECD, *Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note* p. 2 (OECD 2019) [hereinafter the *2019 Policy Note*], available at https://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf (accessed 25 Aug. 2021).
18. OECD, *Transfer Pricing Guidelines*, *supra* n. 10, at pp. 105-106.

appropriate profit".[19] To put this the other way, the market jurisdiction has no claim to tax a share of the profits made by the firm from the design, manufacture and sale of the underlying product or service to customers in its country.

This has been a consistent source of complaint from the developing world and even the developed world. For instance, in 2014, Australia's Treasurer protested that:

> Australian consumers often pay much higher prices compared to United States consumers for identical IT hardware, software, music, games, sporting equipment and fashion, to name a few. Members would also be aware of media reports detailing that some companies selling these products pay little tax in Australia, despite their products selling for much higher prices in Australia than elsewhere around the world...[20]

But the Treasurer's complaint is misconceived – the OECD Transfer Pricing Guidelines make it very clear that the profit attributable to a local marketing operation will be dictated by wage rates, rents, utility costs and other selling expenses, not by the price of the underlying commodity. As the OECD Transfer Pricing Guidelines state:

> In a market economy, the compensation for performing similar functions would tend to be equalized across different activities... [if] a distribution company performs the same functions... selling toasters as it would selling blenders... in a market economy there should be a similar level of compensation for the two activities.[21]

A second real-world implication of the current orthodoxy arises from the fact that every operating subsidiary of a multinational group will, by definition and by design, earn a modest and arm's length return from its activities. In other words, the same net margin that a company engaged in similar activities, owning similar assets and bearing similar risks would earn. By design, those activities will be limited, involving few tangible (and no intangible) assets, and risks can and will be re-located by contract. But because MNEs will often make supra-normal profits, the surplus profit ineluctably gravitates to the entity which owns the intangible assets of the group:

> The overall impact of the prima facie application of the transfer pricing methods... to the centralised intangible asset model is that the Intangible Asset Owner will be allocated all of the profit generated by the sale of consumer technology goods outside of HQ's home jurisdiction … except for the net margin that is retained by the limited risk operational entities... Therefore most, if not all, of the profit of an MNE over and above the return for these limited risk functions will be allocated to the Intangible Asset Owner.[22]

The surplus profit appears in the countries where the intangibles are located. No intangibles will be located in the country in which the customers were located.[23]

Amount A now affords the market jurisdiction a claim to tax on a share of the profits made by the entire group. That situation will extend to a portion of the profits attributable to the development, manufacture and sale of the underlying product or service to customers in its country. Consequently, the returns safely locked away in Caribbean tax havens, or European patent box regimes, would no longer be inviolate.

3. Why Pillar One?

If Pillar One were to change the most fundamental principles of international tax, one might have expected to see these departures from the orthodoxy of international tax, so vigorously defended until now, buttressed by some serious theoretical justification. Instead, a number of justifications were offered, none of them especially convincing, and some contradictory.

One justification was to claim the realities of modern business have changed dramatically:

> Pillar One seeks to adapt the international income tax system to new business models through changes to the profit allocation and nexus rules applicable to business profits.[24]

The impression was, the rules had been sound in the past, but recent developments in big tech had found them wanting.

However, this impression is wrong, or at least misleading. On the one hand, the ability of businesses to operate in other countries without a significant physical presence there was a problem long before the internet arrived. Various industries such as travel and tourism, insurance and re-insurance, freight and logistics, airlines and shipping, telecommunications, international capital markets and even sales of goods by mail order had all showed it was possible to flourish without needing a sizeable physical presence in the countries of their customers. Typically, these industries operated by having an established network of local agents which, while putatively independent, were often financially and commercially captive to the principal - a branch or subsidiary in substance, if not form. A captive "independent agent" presents much the same pricing problems for the country where the agent is located as an actual subsidiary or PE. The price of dealings between a captive agent and its controlling principal have only slightly more integrity than those between a real parent and its subsidiaries.

19. Id.
20. AU: House of Representatives, Official Hansard (4 Sept. 2014) at p. 9745, Ministerial Statement, G20: OECD Tax and Transparency, by Joe Hockey, MP.
21. OECD, *Transfer Pricing Guidelines*, *supra* n. 10, at p. 106.
22. M. Ogier, *Mind the gap: the arm's length principle and MNE value creation*, Australian National University, Crawford Scholl of Public Policy, Tax and Transfer Policy Institute (TTPI), Working Paper No. 7/2016 p. 19 (Sept. 2016), available at https://taxpolicy.crawford.anu.edu.au/sites/default/files/publication/taxstudies_crawford_anu_edu_au/2016-09/final_m_ogier_mind_the_gap_wp_sep_2016.pdf (accessed 25 Aug. 2021). *See also* R Vann, *Reflections on Business Profits and the Arm's Length Principle*, in *The Taxation of Business Profits under Tax Treaties* (B Arnold, J. Sasseville & E. Zolt eds., Canadian Tax Fund. 2003).
23. Jane Gravelle puts it this way: "the standard international agreements historically have allocated the first right of taxation of profits to the country where the asset is located. This location may be where the asset is created (e.g., from investment in buildings, equipment, or research) or where the rights to the asset have been purchased, which may happen easily with intangible assets, such as drug formulas or search algorithms. Many U.S. multinationals have sold the rights to intangible assets to affiliates in other countries to serve the foreign market." *See* US Congressional Research Service, *International Tax Proposals Addressing Profit Shifting: Pillars 1 and 2* (US CRS 2021), available at https://crsreports.congress.gov/product/pdf/IF/IF11874 (accessed 25 Aug. 2021).
24. OECD, *Pillar One Blueprint*, *supra* n. 14, at p. 11.

And at the other end of the business cycle, article 5(4) of the OECD Model exacerbated the issue by downplaying the significance of some activities, i.e. places and people would not amount to a PE if they were in the country "solely for the purpose of purchasing goods or merchandise" or "solely for the purpose of storage, display or delivery of goods...".[25] The Commentary on Article 5(4) of the OECD Model was quite candid to the effect that:

> to a considerable degree, these provisions limit the definition in paragraph 1... It is recognised that such a place of business may well contribute to the productivity of the enterprise...[26]

The rationale for excluding these places was not any matter of principle; it was because doing otherwise would make things difficult for the transfer pricing rules: "the services it performs are so remote from the actual realisation of profits that it is difficult to allocate any profit to the fixed place of business in question".[27] It was always a failing in the design of the international rules of income tax that a company was seen to be carrying on business only where it maintained a sizeable investment in people, equipment or premises, and only if those people and premises were deployed doing things at the middle and end of the production cycle.

Moreover, the impression that the rules were being jeopardized by big tech is wrong because there are many causes of the current problems which have little to do with big tech, such as corporate game-playing even by traditional MNEs operating in the world of tangible goods and physical services, collusion by national tax authorities in these games, international tax competition, the shortcomings of the transfer pricing edifice and so on.[28]

As a result, the rules ensured that a company was seen to be carrying on business in far fewer countries than a more realistic view of a group's sphere of operations would require. It was not taxable in many places from which it sourced its inputs, and it was not taxable in many of the places to which its goods and services were destined. Big tech highlighted the shortcomings, but the shortcomings were there already.

However, there is one way in which the new business models presented a novel challenge to the existing rules. In the usual business models, businesses sold their products to customers. In the world of big tech, customers also provide inputs to businesses, and the operators of digital platforms use these inputs in various ways to derive significant value. For instance, users of search engines willingly provide their personal data, or allow their viewing behaviour to be tracked around the internet, and this information is used by the operator to promise its advertising customers a more tailored audience, or else the information itself is sold by the platform operator to its customers. In a similar way, users generate value for a business in the form of entertainment or reviews posted to a site (user-generated content), which attracts other viewers to the site (network effects), and that audience can then be monetized. Not all online platforms involve this paradigm. Online gaming, intermediation platforms or streaming services do not typically acquire these inputs from their customers, but search engines and the social media companies depend almost entirely on this model.

Other justifications were less principled. There was an acknowledgement that domestic politics was playing a part in the decision to pursue something like Pillar One,[29] but responding to the annoyance of citizens is not a matter of high tax policy. Whether politics was a motivating cause for Pillar One or an impediment which needed to be managed is not clear. At other times, the OECD has noted the need for:

> political engagement and endorsement as the interests at stake for members go beyond technical issues and will have an impact on revenues and the overall balance of taxing rights.[30]

Probably both are true. Whether Amount A was made necessary by something special about the world of big tech or whether big tech was simply the event which meant existing shortcomings could no longer be ignored probably no longer matters.

4. The Slow Demolition

4.1. Introductory remarks

While Amount A might have been truly paradigm-shifting, it now seems unlikely to achieve that bold vision. The slow demise of Pillar One can be tracked through the many documents released by the OECD since 2015. After the failure of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project in 2015 to deliver an agreed outcome on Action 1,[31] and the OECD's attempt to re-energize the debate in 2018,[32] some milestones in the development of the proposal that becomes Pillar One are:

25. *OECD Model Tax Convention on Income and on Capital* p. 31 (21 Nov. 2017), Treaties & Models IBFD. The revisions to article 5(4) of the *OECD Model* (2017), which insist that these activities must also be "of a preparatory or auxiliary character", may move the needle, but only slightly.
26. Para. 58, *OECD Model Tax Convention on Income and on Capital: Commentary on Article 5(4)* (21 Nov. 2017), Treaties & Models IBFD.
27. Id., at p. 132.
28. The European Commission has pursued companies dealing in tangible, old-world products like Chrysler, Engie, Fiat, IKEA, McDonalds and Starbucks, as well as the tech companies, such as Amazon and Apple.
29. Dissatisfaction among the public and the political class with the tax outcomes was being observed: "the remote sales of highly digitalised businesses … have called into question the relevance of the existing physical presence rules – not least in the minds of the public and politicians." *See* OECD, *Secretariat Proposal*, *supra* n. 6, at p. 7.
30. OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy, Program of Work* p. 7 (OECD 2019) [hereinafter the *2019 Programme of Work*].
31. OECD, *Action 1 Final Report 2015 – Addressing the Tax Challenges of the Digital Economy* p. 13 (OECD 2015), Primary Sources IBFD [hereinafter the *Action 1 Final Report* (2015)], where it is stated that: "the TFDE discussed and analysed a number of potential options to address these challenges, including through an analysis of their economic incidence, and concluded that … none of the other options analysed by the TFDE … were recommended at this stage". The *Action 1 Final Report* (2015), *supra*, also at p. 13 tried to put a brave face on this arguing that the failure to agree on a way forward might not matter, it was said that: "it is expected that the measures developed in the BEPS Project will have a substantial impact on BEPS issues previously identified in the digital economy, that certain BEPS measures will mitigate some aspects of the broader tax challenges, and that consumption taxes will be levied effectively in the market country."
32. OECD, *Tax Challenges Arising from Digitalisation – Interim Report 2018* (OECD 2018), Primary Sources IBFD.

- January to May 2019: the release of the OECD's Policy Note,[33] the document which first revealed the idea of "two pillars which could form the basis for consensus...",[34] followed by the release of the Public Consultation Document,[35] seeking input from external stakeholders on the twin pillars approach. This action was followed by the release of the Programme of Work,[36] outlining a future for the project which would address "political engagement and endorsement," "technical work... on the economic analysis" and "[the legal] architecture [on] the nature of, and the interaction between, both Pillars...".[37]
- October 2019 – January 2020: the Secretariat Proposal,[38] developed by the OECD Secretariat during 2019 and released, somewhat curiously, in the form of a consultation document (albeit with the approval of the Steering Group of the Inclusive Framework), trying to reconcile some of the disparate agendas and approaches. The Statement on the Two-Pillar Approach[39] welcomed the secretariat model and re-stated the architecture of a "Unified Approach" in the Secretariat Proposal. It was accompanied by a Revised Programme of Work.[40]
- October 2020: the release of the Pillar One Blueprint,[41] which was an endorsement by the Inclusive Framework,[42] the accompanying Public Consultation Document,[43] and the economic modelling on the Pillar One and Pillar Two proposals.[44] The economic modelling contains the estimate that:

  > Pillar One [as described in the Pillar One Blueprint] would involve a significant change to the way taxing rights are allocated among jurisdictions, as taxing rights on about USD 100 billion of profit could be reallocated to market jurisdictions under the Pillar One rules.[45]
- July 2021: the release of the Statement on a Two-Pillar Solution,[46] accompanying media release[47] and summary brochure.[48]

The Pillar One Blueprint contained a flow chart with ten steps to explain just how Amount A would be calculated and allocated. Each of those steps was a point at which the scope and impact of Amount A could be expanded or restricted, and several have been tweaked to shrink Amount A. This article charts the demolition of Pillar One through the changes to three key steps – changes which have reduced the number of groups liable to pay Amount A, reductions to the potential size of Amount A and the reinstatement of arm's length pricing in the guise of "a marketing and distribution profits safe harbour will cap".

The consequence of re-configuring these steps has meant the measure, which some had hoped might extend to more than 2,300 corporate groups worldwide,[49] by July 2021 is now expected to cover only about 100,[50] and perhaps fewer than 80.[51] Interestingly, it was estimated in October 2020 that Amount A could possibly transfer as much as USD 100 billion of corporate profit under not-entirely-random assumptions.[52] That figure was repeated in July 2021, and it is not clear whether it has been updated for the significant changes to the computation of Amount A which occurred in the meantime.[53]

4.2. Reducing the number of affected groups

Deciding which multinational groups would be affected by Amount A has been a source of constant negotiation

33. OECD, *2019 Policy Note*, *supra* n. 17.
34. Id., at p. 1.
35. OECD, *Public Consultation Document – Addressing the Tax Challenges of the Digitalisation of the Economy*, Base Erosion and Profit Shifting Project (OECD 2019), Primary Sources IBFD, also available at www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf (accessed 25 Aug. 2021).
36. OECD, *2019 Programme of Work*, *supra* n. 30.
37. Id., at p. 7.
38. OECD, *Secretariat Proposal*, *supra* n. 6, at p. 4, which states that: "in light of the high stakes and the need for a clear direction, the Secretariat has undertaken extensive consultations to develop a "Unified Approach" which is outlined in this document".
39. 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* p. 8 (OECD 2020) [hereinafter the *2020 Statement*], available at www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf (accessed 25 Aug. 2021), where it is stated that: "the Inclusive Framework welcomes the Secretariat's work to develop a 'Unified Approach' to Pillar One").
40. Id., at Annex A. Programme of Work to Develop a Consensus-Based Solution to Pillar One Issues.
41. OECD, *Pillar One Blueprint*, *supra* n. 14. A draft of this document, dated August 2020, had been leaked to the public in September 2020.
42. OECD, *Cover Statement by the Inclusive Framework on the Reports on the Blueprints of Pillar One and Pillar Two* (OECD 2020), available at 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 25 Aug. 2021).
43. OECD, *Public Consultation Document – Reports on the Pillar One and Pillar Two Blueprints* (OECD 2020), available at www.oecd.org/tax/beps/public-consultation-document-reports-on-pillar-one-and-pillar-two-blueprints-october-2020.pdf (accessed 25 Aug. 2021).
44. OECD, *Economic Impact Assessment*, *supra* n. 9.
45. Id., at p. 10
46. OECD, *2021 Statement*, *supra* n. 4.
47. OECD, *2021 Media Release*, *supra* n. 4.
48. OECD, *Addressing the tax challenges arising from the digitalisation of the economy*, OECD/G20 Base Erosion and Profit Shifting Project (OECD 2021) [hereinafter the *2021 Highlights Brochure*], available at www.oecd.org/tax/beps/brochure-addressing-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf (accessed 25 Aug. 2021). For the most part, it seems the OECD, *2021 Statement*, *supra* n. 4 simply restates and endorses the OECD, *Pillar One Blueprint*, *supra* n. 14, and it is the OECD, *Pillar One Blueprint*, *supra* n. 14, which provides the authoritative detail of Pillar One. However, the *2021 Statement*, *supra* n. 4 and even the *2021 Highlights Brochure*, *supra* change important elements of the detail, often explicitly but perhaps also by implication. It is clear the design did not stop evolving in October 2020, with the *Highlights Brochure*, *supra* of July 2021 announcement acknowledging that several elements of the design are still incomplete.
49. OECD, *Pillar One Blueprint*, *supra* n. 14, at p. 63. *See also* A. Tillett & T. McIlroy, *G7 tax deal pressures 30pc company rate*, Australian Financial Review (6 June 2021), available at www.afr.com/politics/federal/global-tax-deal-revives-push-to-cut-30pc-company-rate-20210606-p57yhn (accessed 3 Sept. 2021) and R. Goulder, *The Cost of Change: Pillar One reduced to the Back of a Napkin,* 103 Tax Notes Intl. [issue number], p. 112 (2021).
50. OECD, *2021 Highlights Brochure*, *supra* n. 48, at p. 14, where it is stated that: "… Pillar One applies to about 100 of the biggest and most profitable MNEs … but Pillar Two applies to hundreds more MNEs …".
51. M. Devereux & M. Simmler, *Who Will Pay Amount A?*, 36 EconPol Policy Brief No. 5 (2021), available at www.econpol.eu/sites/default/files/2021-07/EconPol_Policy_Brief_36_Who_Will_Pay_Amount_A_0.pdf (accessed 25 Aug. 2021).
52. OECD, *Economic Impact Assessment*, *supra* n. 9, at p. 15.
53. OECD, *2021 Highlights Brochure*, *supra* n. 48, at p. 3.

Table – Evolution of the scope of Pillar One

	Policy Note (January 2019)	**Unified Approach (October 2019)**	**Pillar One Blueprint (October 2020)**	**Statement on a Two-Pillar Solution (July 2021)**
Included activities	Highly digitalized businesses MNEs with "limited risk distribution structures in market jurisdictions"	Highly digitalized businesses, which interact remotely with users Other businesses that market their products to consumers, and use digital technology to develop a consumer base	Automated Digital Services (ADS) Consumer-facing businesses	[Activity test removed]
Excluded activities	[No exclusions identified]	Extractive industries Commodities Possibly financial services	Natural resources. Financial services. Construction, sale and leasing of residential property. International airline and shipping. Possibly pharmaceuticals.	Extractive industries. Financial services.
Size	[No size requirement identified]	Worldwide turnover of more than EUR 750 million	Worldwide turnover of more than EUR 750 million	Worldwide turnover more than EUR 20 billion
Profitability	[No minimum profitability requirement identified]	"An agreed level of profitability" (regarded as the reward for routine functions) would be excluded from the pool of profits available for re-allocation to market jurisdictions	Unquantified profitability threshold Determined by ratio of profit before tax to gross revenue	Profit before tax more than or equal to 10% of gross revenue
Segmentation	[No discussion of whether to determine Amount A for business segments or entire groups]	Future work needed to decide whether profits can be determined separately for each "operating segments based on business line"	Segmentation would be required to appropriately target the new taxing right, but "segmentation will be limited to a minimum"	Tests to be applied *prima facie* on a whole of group basis. Tests to be applied to segments only where segments are disclosed in financial accounts and a segment meets the scope requirements.

since 2019. The target groups have been defined in terms of activities (both in-scope and out-of-scope activities), size (measured by revenue) and superior profitability (profit in excess of a minimum threshold).[54] There was a consequent decision to be made whether these tests would be applied to the group as a whole, individual business segments or some combination (group for some items such as size, and segment for others such as profitability). All the components have been tinkered with as shown in the Table.

The group versus segment debate is highly consequential for companies, which have both profitable and unprofitable segments. The significance was recognized from the outset, with a clear preference for deciding matters on a business line basis:

> the fact that the profitability of an MNE group can vary substantially across business lines, regions or markets suggests that the relevant measure of profits may need to be determined on a business line and/or regional/ market basis. Otherwise, in the case of a business that combines a low-margin retail business line with a high-margin cloud-computing business line, distortions would arise that could benefit jurisdictions where the retail sales are concentrated, at the expense of jurisdictions where cloud computing sales occur.[55]

Consequently, the over-turning of the original decision in October 2019 to use segmentation based on the financial statements, repeated in October 2020, by a new formulation ("segmentation will occur only in exceptional circumstances..."[56]) will represent most likely a serious contraction to Amount A, excluding some groups altogether from these rules on the basis that, while they meet the size threshold as a group, the blending of profitable and loss-making operations within the group means they now fail to meet the profitability requirement. It has been noted, for example, that Amazon might fall outside

54. It was always accepted that the regime would only apply to MNEs – i.e. a single entity (or group of related enterprises) with operations in more than one country.

55. OECD, *Secretariat Proposal*, *supra* n. 6, at p. 14.
56. OECD, *2021 Statement*, *supra* n. 4, at p. 2.

Amount A, as it combines the very profitable Amazon web serviceswith the rather less profitable Amazon online sales platform to produce a combined profit ratio which may well fall under the threshold.[57]

4.3. Reducing the size of Amount A

A second piece of the puzzle is computing just how much of the earnings of affected groups would be available to be allocated to market countries. First, Amount A would be a profit-based computation,[58] not a gross flow computation, meaning source state withholding taxes were unlikely.[59] And it was clear from the outset that the base for computing Amount A could not be the legislated tax base of either the residence country or the various source states. By October 2019, this had become a firm proposal to use:

> profits... derived from the consolidated financial statements under the accounting standards of the headquarters jurisdiction prepared in accordance with the Generally Accepted Accounting Principles (GAAP) or the International Financial Reporting Standards (IFRS).[60]

Initially, there was no discussion about making extensive adjustments to the figures appearing in the accounts except for a reference to possibly adjusting for differences between the various standards.[61] By the time of the Pillar One Blueprint in October 2020, this idea had been abandoned,[62] but other adjustments had now been added. These adjustments included excluding income tax as an expense, excluding dividends and gains on shares from income, and losses from shares as an expense, adding back expenses not deductible "in most Inclusive Framework jurisdictions for public policy reasons", and possibly also making adjustments for income derived from joint ventures and interest expenses from transactions with related parties.[63] Losses would be carried forward to reduce Amount A in future years possibly without a time limit and possibly surviving changes to business structure. Most importantly, the carry-forward of losses would extend to "pre-regime losses".[64] With regard to established entities, this is probably not an issue, but for start-up entities, especially in the tech sector, carrying forward existing losses into the post-Pillar One world means source states may be waiting a long time before an Amount A appears. Almost all of the proposed adjustments to financial accounts since 2019 contract the size of Amount A.

Next, it was clear from mid-2019 that some amount representing "deemed routine profits" would be immune from reallocation, so that Amount A would comprise only "residual profits".[65] The logic behind this step was that Pillar One should "[not] disturb the actual allocation of the remuneration derived from actual routine activities under the current transfer pricing framework".[66] In 2019, the proposal was for unspecified "fixed percentage(s), possibly with variances by industry" to be removed, but by June 2021, the single figure of 10% of profit for all industries and for all multinational groups was announced by G7 Finance Ministers as the floor which would be immune from re-allocation. It seems that the "routine profit" calculation is an all-of-group calculation, so that it bears no relationship to the level of functions actually performed in any country or by any company. To put this another way, 10% of the profit of a group will be immune from reallocation even if it was earned with little human footprint in any country.

4.4. Reinstating arm's length pricing

In December 2019, US Treasury Secretary Mnuchin wrote to the OECD Secretary General proposing that the goals of Pillar One could be substantially achieved by making Pillar One a "safe harbour" regime.[67] Just what this might mean was not explained further: a "safe harbour" for whom; a "safe harbour" from what?

The US proposal quickly became tied up with what became known as a double-counting issue, identified in the October 2019 Secretariat Proposal. Amount A is meant to resolve the problem of profit being earned without a physical presence, but it was always clear that Pillar One would have to deal with:

> situations where there is no physical presence, but also... those where there is. Otherwise, taxpayers could simply side-step the new rules by using alternative forms of an in-country presence... making the new taxing right elective for taxpayers and creating an open invitation for tax planning.[68]

So would a country where the non-resident has a presence collect both the tax on the local presence calculated under the current rules, and a share of Amount A? In the Secretariat Proposal, it seemed the answer was yes. All market countries would share in Amount A, and those countries where there was also a presence would enjoy Amount B ("fixed remuneration for baseline marketing and distribution functions that take place in the market juris-

57. J. Jolly, *Global G7 deal may let Amazon off hook on tax, say experts*, The Guardian (7 June 2021), available at www.theguardian.com/technology/2021/jun/06/global-g7-deal-may-let-amazon-off-hook-on-tax-say-experts (accessed 25 Aug. 2021). *See also* R. Mason, *The 2021 Compromise*, 103 Tax Notes Intl. 26 July 2021, p. 469 (2021).
58. OECD, *2019 Policy Note*, *supra* n. 17, at p. 3, where it stated that: "members of the Inclusive Framework also agreed that any new rules to be developed should not result in taxation when there is no economic profit …".
59. Id., at p. 2, which reads: "the Inclusive Framework is open to exploring solutions [which] could include withholding taxes where they do not result in double taxation".
60. OECD, *Secretariat Proposal*, *supra* n. 6, at p. 14.
61. Id., at p. 17, where it is stated that: "standardised adjustments would need to be made to adjust for different accounting standards".
62. OECD, *Pillar One Blueprint*, *supra* n. 14, at p. 100, which reads: "no specific book-to-book harmonisation adjustments (to account for variances between different GAAP)".
63. Id., at p. 101.
64. Id., at pp. 117 and 118, where it is stated that: "a positive tax base for Amount A (in excess of the profitability threshold determined under the formula) would arise only after all historic losses accumulated in the loss account of the group (or segment where relevant) have been absorbed …". There was even a discussion about computing the profitability test on a rolling basis (carrying forward a "profit shortfall") – an entity would not be affected in year 1 or in year 2 if it earned a profit of 4% in year 1 and 12% in year 2 because the average was still under 10%. *See* OECD, *Pillar One Blueprint*, *supra* n. 14, at p. 120. This idea appears to have been abandoned.
65. OECD, *Secretariat Proposal*, *supra* n. 6, at p. 14.
66. Id.
67. *OECD releases statement on two-pillar proposal towards taxing digital economy* (31 Jan. 2020), News IBFD, referring to "a 'safe harbour' approach to Pillar One, as proposed in a letter by the US Treasury Secretary, Stephen Mnuchin, on 3 December 2019 …".
68. OECD, *Secretariat Proposal*, *supra* n. 6, at p. 6.

diction"), and, in some cases, even an Amount C (some "additional profit where in-country functions exceed the baseline activity compensated under Amount B") with those amounts calculated under the existing arm's length rules.[69] But that position was qualified by other passages which referred to the need for:

> approaches to address any risk of double counting or duplications between the three possible types of taxable profit (Amounts A, B and C) that may be allocated to a market jurisdiction [and] in particular interactions between the new taxing right under Amount A and current profit allocation rules.[70]

The double-counting issue was still very much alive in October 2020 and received more detailed treatment in the Pillar One Blueprint. Whatever may have been the original intention, by the time of the Statement in July 2021, the "safe harbour" proposal came to mean, Amount A is elective and a ceiling. Arm's length pricing would be re-inserted into the process as a cap on the size of Amount A:

> where the residual profits of an in-scope MNE are already taxed in a market jurisdiction, a marketing and distribution profits safe harbour will cap the residual profits allocated to the market jurisdiction through Amount A.[71]

So, if a country happens to garner an unexpectedly large share of a foreign group's profits through Amount A, the proposal would wind back the share in cases where "the residual profits of an in-scope MNE are already taxed in a market jurisdiction". In other words, if the group already has a subsidiary or PE on the ground. If triggered, this "safe harbour" means the market jurisdiction would be limited to taxing just the marketing and distribution profits, using the current rules (an outcome this entire project was meant to overturn).

That situation gives rise to the avoidance opportunity the Secretariat Proposal had identified. With a store, the group will pay tax on the local marketing and distribution profits; without a store, the market country can get its full share of Amount A. It is hard to predict *ex ante* just which number will provide to be larger but the "safe harbour cap" proposal gives the company a way of ensuring it pays the lower amount. It seems possible that many large market countries will get no more revenue from most of the corporate giants than they currently do because most would have a local presence, its main function is market and distribution. Where that is the case, the market country is stuck with arm's length pricing again – a markup on costs.

5. Enter the UN

The argument so far is, Pillar One is gradually collapsing. The next question is, can this decay be negated by the UN which has decided to enter the fray?

In 2017, the UN Committee of Experts on International Cooperation in Tax Matters (the "UN Tax Committee") formed a subcommittee on Digitalization of the Economy, which was given the task of developing options for addressing the tax issues raised by the digital economy.[72] By the time of the UN Tax Committee's meeting in October 2020, the Subcommittee decided to recommend that the tax issues be addressed by inserting a new article, article 12B, into the UN Model,[73] allowing source states to retain taxes claimed under domestic law.[74] The recommendation was adopted at the UN Tax Committee's meeting in April 2021 (albeit with a sizeable minority opposing the measure), along with a proposed Commentary on Article 12B of the UN Model[75] and consequential changes to other articles.[76]

The proposed text of article 12B in its form current at the time of writing this article, had adopted the familiar design seen in articles 10, 11 and 12 of the OECD Model and the UN Model,[77] i.e. imposing a cap on the tax on income from "automated digital services" borne by a resident or local PE and beneficially owned by a resident of the other contracting state, unless the income is effectively connected to a PE or fixed base of the non-resident in the source state.

But proposed article 12B(3) of the UN Model is a novel element. If the company maintains appropriate accounting information and provides it to the source state, the company can insist that the country of the customer abandon its tax on gross payments and apply net basis taxation instead – it can ask to be taxed on the "qualified profits from automated digital services for the fiscal year concerned to taxation at the tax rate provided for in the domestic laws of that State". But this election is only available if the financial information needed for the calculations is prepared and made available to the revenue authorities of the source state.

The calculation of the amount of "qualified profits" would be determined in the following series of steps:

69. Id.
70. Id., at p. 10.
71. OECD, *2021 Statement*, *supra* n. 4, at p. 2.
72. *See*, for more information, UN, Department of Economic and Social Affairs, Financing, *Subcommittee on Tax Challenges Related to the Digitalization of the Economy*, available at www.un.org/development/desa/financing/what-we-do/ECOSOC/tax-committee/subcommittees/digitalization-economy (accessed 25 Aug. 2021).
73. *UN Model Double Taxation Convention between Developed and Developing Countries* (1 Jan. 2017), Treaties & Models IBFD.
74. UN Committee of Experts on International Cooperation in Tax Matters (the "UN Tax Committee"), Twentieth Session, Tax consequences of the digitalized economy – issues of relevance for developing countries Co-Coordinators, Report, E/C.18/2020/CRP.41, available at www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-10/CITCM%2021%20CRP.41_Digitalization%2010102020%20Final%20A.pdf (accessed 25 Aug. 2021).
75. UN Tax Committee, Twenty-second Session, Tax consequences of the digitalized economy – issues of relevance for developing countries, E/C.18/2021/CRP.1, available at www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2021-04/CITCM%2022%20CRP.1_Digitalization%206%20April%202021.pdf (accessed 25 Aug. 2021). The UN Tax Committee's reply to the minority is in the Commentary proposed for article 12B: [author's comment: "if you feel strongly about it, just don't include it in your treaties"]. Id., at p. 12.
76. UN Tax Committee, Twenty-second Session, Proposed Changes to the UN Model including the Commentaries thereon as a consequence of the proposed inclusion of Article 12B on automated digital services, E/C.18/2021/CRP.15 Rev.1, [hereinafter *April 2021 Proposal*] available at www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2021-05/CRP15_Rev.1%20_Article%2012B%20Consequential%20Changes%20final.pdf (accessed 25 Aug. 2021).
77. *UN Model Double Taxation Convention between Developed and Developing Countries* (1 Jan. 2017), Treaties & Models IBFD.

- Initially, the gross revenue from arising in the contracting state from providing automated digital services is calculated.
- That gross revenue stream is then reduced by the profitability ratio to identify the portion of the gross payments that approximates the profit from local sales. The profitability ratio is calculated as, annual profits divided by annual revenue, using figures from the financial statements. The profitability ratio to be used will be one of four possibilities set out in article 12B of the UN Model:
  - if the seller is part of a multinational group and accounts are prepared for the digital services segment of the business, the ratio used is that of the digital services business segment of the group;
  - if the seller is part of a multinational group, segment accounts are not prepared, and the ratio for the multinational group is higher than the ratio of the seller considered in isolation, the ratio used is that of the entire group;
  - if the seller is not part of a multinational group, the ratio used is that of the digital services segment of its business, provided segmented accounts are prepared; or
  - if none of these apply, it is the profitability ratio of the seller.
- That figure is then apportioned, with 30% being available to be taxed in the source state at the rate stipulated in local law [the "qualified profits"], and the remaining 70% being taxable in the residence country at the rate stipulated in its local law.

As with the Inclusive Framework's methodology, this approach jettisons the following three key dogmas of international tax law: (i) the PE threshold; (ii) separate entity taxation; and (iii) arm's length pricing. It replaces these dogmas with the multinational group as the relevant tax unit instead of the individual seller, a formula to identify the profit component of a gross revenue flow and the apportionment of profit between source and residence countries using a 30:70 split.

This position contrasts the Inclusive Framework's methodology. There is no blanket exclusion of companies with turnover below a threshold, there is no floor on the minimum amount of sales that must be made in the source state before it can retain its tax, there is no exclusion of firms that do not reach the minimum 10% profitability level, and the share of profits available to market countries is set at 30%.

One especially problematic aspect of the UN's approach is that article 12B contains none of the source rules which exist in the Pillar One Blueprint. Instead of source rules, proposed article 12B of the UN Model uses a single test. Is a local entity bearing the expense? But sourcing revenue is critical, and this test is inadequate. For instance, if a person in Country A uploads content to a platform operated by a resident of Country B, which is seen by a viewer in Country C, who is made to endure an advertisement paid for by a firm in Country D, where does the platform operator in Country B earn its income? On what basis does Country A or Country C get to share in Amount A, as money flows to the platform operator only from country D?[78] The UN rule would allow Country D (only) to sustain its tax claim. The OECD rule would entitle Country C (only) to a share of Amount A. Neither rule allows a revenue claim for Country A.

Once revenue flows are abandoned as the basis for determining source, it does become difficult to find a sound conceptual basis for allocating Amount A that is also administrable. The OECD's Final Report on Action 1 had considered using a multi-factor "significant economic presence" test[79] and the European Union has proposed its own multi-factor "significant digital presence" test,[80] as both organizations saw using revenue flows as a problem. The rules in the Pillar One Blueprint identify different source states for different revenue streams, and, on the whole, seem to be a fair attempt at deciding where revenue is earned once one abandons the country which the cash leaves.[81] No doubt the decision to use cash flows was driven by two overriding considerations. The tax to be imposed will likely be a gross-basis withholding tax on cash flows, and this is the country whose tax base is likely being depleted by deductible payments offshore. Even if net basis taxation is applied, the source state remains the same. But focusing on cash flows is a serious flaw in what should be a search for evidence of a "sustained and significant involvement in the economy of a specific market".[82]

Next, the proposed article 12B of the UN Model is narrower than the Inclusive Framework's model, as it is only dealing with income from automated digital ser-

78. *April 2021 Proposal*, *supra* n. 76, at p. 10.
79. OECD, *Action 1 Final Report* (2015), *supra* n. 31, at p. 107.
80. European Commission, Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence p. 8 (21 March 2018) COM(2018) 147 final, Primary Sources IBFD, also available at https://ec.europa.eu/taxation_customs/system/files/2018-03/proposal_significant_digital_presence_21032018_en.pdf (accessed 25 Aug. 2021). The proposal sits in abeyance at present. At its meeting in March 2021, the European Council noted, "our strong preference for and commitment to a global solution on international digital taxation ... within the framework of the OECD [but remain] ready to move forward if the prospect of a global solution is not forthcoming ... at the latest by 1 January 2023." *See* Statement of the Members of the European Council (25 March 2021) SN 18/21, available at www.consilium.europa.eu/media/48976/250321-vtc-euco-statement-en.pdf (accessed 25 Aug. 2021).
81. OECD, *Pillar One Blueprint*, *supra* n. 14, at ch. 4. The rules stipulate a source for revenue from sales of online advertising, sales of user data, intermediation services, providing access to digital content, data storage, sales of goods, provision of services and licensing intangibles used in the provision of goods and services. There are also issues regarding revenue from selling online advertising is allocated to the jurisdictions where the viewers are located; revenue from intermediating the sale of goods is sourced equally between the countries of the purchasers and sellers of the underlying commodity; revenue from intermediating services is allocated entirely to country of the purchaser; cloud storage is sourced where the customer is; revenue from streaming is allocated entirely to the country of the subscriber; revenue from the sale of goods is allocated to the country of final delivery to the consumer; and so on.
82. A.S. Samari, *The OECD Secretariat Proposal for a "Unified Approach" under Pillar One: Strengths and Weaknesses of the New and Revised Nexus and Profit Allocation Rules*, 27 Intl. Transfer Pricing J. 2 (2020), Journal Articles & Opinion Pieces IBFD. The comments in Samari, *supra* were made as criticisms of the *Secretariat Proposal, supra* n. 6, but they apply equally to the proposed article 12B.

vices. The proposed article 12B of the UN Model is only enlivened where the income is not already connected to a PE or a fixed base in the country. Presumably in cases where a PE exists, the source state must go back to using arm's length pricing, an outcome which the source state will probably not appreciate; the Inclusive Framework's approach extends both to situations where a local presence does exist and to situations where none exists, effectively making arm's length pricing irrelevant, although as noted in sections 4.1. and 4.4., the proposed "marketing and distribution profits safe harbour" in the Inclusive Framework proposal may lead to the same outcome.

Looking at the proposed article 12B of the UN Model more broadly, the design that has emerged from the Subcommittee differs from the Inclusive Framework's model in more fundamental ways. First, the UN approach seems directed at preserving current digital services taxes; the assumption is that the primary source state tax is going to be a gross basis withholding tax, and a profit-based calculation is only available under certain conditions. The proposed Commentary on Article 12B of the UN Model acknowledges this early on, saying it will suit many countries, and even some taxpayers.[83]

The Inclusive Framework's approach seeks exactly the opposite goal. The impetus is to eliminate all the existing digital services taxes, and the reward for agreeing to switch off those taxes is access to a share in the group's profit. In other words:

> this package will provide for appropriate coordination between the application of the new international tax rules and the removal of all Digital Service Taxes and other relevant similar measures on all companies.[84]

Even more fundamentally, the UN sees the problem as confined to the digital economy and the solution to lie in a bilateral agreement, rather than the more ambitious combination of a multilateral instrument accompanied by model (and hopefully uniform) domestic legislation to lay claim to Amount A and allow tax credits for amounts collected offshore, along with guidance materials. This choice is the fatal flaw in the UN proposal, making it hostage to the willingness of other countries to negotiate or renegotiate a tax treaty, an agreement to include such a provision in the tax treaty, and to the protracted timetable that accompanies negotiating any treaty. It is not inevitable that the digital giants will be sufficiently annoyed at local digital services taxes (especially if they can easily pass on the cost to local customers), or that their governments will be responsive to their complaints, that the usually glacial pace of treaty development will suddenly change. In short, the UN's approach may not produce fruit for years, for decades or ever, while the Inclusive Framework offers a timetable that sees a system in operation in 2023.

6. Conclusion: A Better Future

The conclusion of this article is that we can be fairly sure what the future of international tax looks like. Even if Pillar One does not get us there, it certainly marks the start of the journey. Over the next 75 years, the methodology common to the approaches of both the Inclusive Framework and UN Subcommittee will gradually expand and be refined. The shared approach signals the onset of the demise of the following three key dogmas of international tax: (i) the PE threshold; (ii) separate entity taxation; and (iii) arm's length pricing. These dogmas are replaced by the multinational group and profit allocation formulae. And we should not forget Amount B which signals a willingness to abandon arm's length pricing in favour of arbitrary, but certain, fixed prices. The shibboleth of arm's length pricing has started to succumb to formulae and to arbitrary numbers.

One can be confident about this because the approach now has the imprimatur of so many countries, both at the Inclusive Framework and in the UN Tax Committee. Compare this to the work of European Commission since 2011 to promulgate its Common Consolidated Corporate Tax Base (CCCTB), a measure which includes the apportionment of consolidated group profits among European countries. The failure of the Commission to bring that project to fruition, and the attempt to relaunch it in 2016, demonstrates how firmly the current orthodoxy has been defended by the countries which benefit from it. The resistance to change can be seen in declamations in the OECD Transfer Pricing Guidelines[85] and the protestations of a minority in the UN Subcommittee, who defended the PE threshold[86] and the separateness of individual companies within a group.[87] I remain unconvinced that the "evolution of the ALP [arm's length pricing] is [a] promising way forward".[88] There may be an ugly period in which arm's length pricing sits alongside formulae and arbitrary numbers.[89] Nevertheless, Pillar One, even a meagre and depleted Pillar One, hopefully signals the ultimate death of the fatuous "arm's length" incantation. That death cannot come soon enough.

83. *April 2021 Proposal*, *supra* n. 76, at p. 9.
84. OECD, *2021 Statement*, *supra* n. 4, at p. 3.
85. OECD, *Transfer Pricing Guidelines*, *supra* n. 10, at p. 38, where it is stated that: "OECD member countries continue to support strongly the arm's length principle [because] no legitimate or realistic alternative to the arm's length principle has emerged. Global formulary apportionment, sometimes mentioned as a possible alternative, would not be acceptable in theory, implementation, or practice".
86. *April 2021 Proposal*, *supra* n. 76, at p. 10, which reads: "these members did not agree that taxing rights should be allocated to the source jurisdiction based on mere sales".
87. *April 2021 Proposal*, *supra* n. 76, at p. 10, which reads: "it is not clear that the entity within the multinational group that ultimately provides the automated digital service has earned that part of the worldwide profit of the multinational group of entities that should be reallocated to the market jurisdiction".
88. U. Schreiber et al., *Why the Arm's Length Principle Should Be Maintained*, 27 Intl. Transfer Pricing J. 6 (2020), Journal Articles & Opinion Pieces IBFD.
89. J. (Jinyan) Li, *The Legal Challenges of Creating a Global Tax Regime with the OECD Pillar One Blueprint*, 75 Bull. Intl. Taxn. 2, sec. 4.5. (2021), Journal Articles & Opinion Pieces IBFD, where the author states that: "it might be better for the OECD to be upfront about this reality and retire its traditional position that formulary allocation method is inconsistent with the arm's length principle. It would be even better to acknowledge that the arm's length principle, an original pillar of the international tax system, can be repurposed or retrofitted for the digital economy. Otherwise, the ambivalence about the arm's length principle may lead to divergent national approaches to interfacing Pillar One and existing transfer pricing law".

