taxnotes federal

Volume 167, Number 11 ■ June 15, 2020

A Seat at the Table: Thought Leaders Discuss OECD's Plans on Digital Economy Taxation

by Peter A. Barnes, H. David Rosenbloom, Steven D. Felgran, Ara Stepanyan, Helen Hecht, Richard D. Pomp, Rick Minor, and Aleksandra Bal

Reprinted from *Tax Notes Federal*, June 15, 2020, p. 1901

For more *Tax Notes* content, please visit www.taxnotes.com.

© 2020 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

A Seat at the Table: Thought Leaders Discuss OECD's Plans on Digital Economy Taxation

by Peter A. Barnes, H. David Rosenbloom, Steven D. Felgran, Ara Stepanyan, Helen Hecht, Richard D. Pomp, Rick Minor, and Aleksandra Bal

Global Roundtable is a regular series appearing in *Tax Notes Federal*, *Tax Notes State*, and *Tax Notes International* that brings together experts from each discipline to help advance the discussion of tax issues.

In the first installment, the authors discuss whether the OECD — in light of the universal disruption caused by the COVID-19 pandemic — should release its recommendations for taxing the digital economy this year. If it does, will state, federal, and international governments be prepared to act? If it does not, what steps can or should those governments take?

This article is intended for general information purposes only and does not and is not intended to constitute legal advice. The reader should consult with legal counsel to determine how laws or decisions discussed herein apply to the reader's specific circumstances.

Copyright 2020 Peter A. Barnes et al.
All rights reserved.

OECD Pillar 1: It's an A for Effort, But We Need Plan B

Peter A. Barnes

H. David Rosenbloom

Peter A. Barnes is of counsel with Caplin & Drysdale Chtd. in Washington and a senior fellow at the Duke Center for International Development at Duke University. H. David Rosenbloom is a member with Caplin & Drysdale in Washington, director of the international tax program at New York University School of Law, and a member of Tax Analysts' board of directors.

Thomas Edison famously never failed in experiments to develop the lightbulb; he just discovered 10,000 prototypes that did not work.

That same unstoppable attitude underlies the OECD's effort to achieve a global consensus on an income tax for large digital and consumer-facing companies. This would necessarily include a means of collecting revenue from the new tax, and an allocation of the revenue among 100-plus countries regardless of whether the companies have a taxable presence in the countries where they find markets.

For more *Tax Notes® Federal* content, please visit www.taxnotes.com.

So should the OECD continue its push, notwithstanding the COVID-19 pandemic and the resulting economic and political turmoil? Absolutely! The sooner the OECD unveils its proposal, the sooner we can all analyze it and consider alternatives that might more successfully light the night.

The current work of the OECD absorbs all the oxygen in the international tax world, so there is no room to discuss other ways in which market countries can sensibly raise additional tax revenue from international transactions. Countries aggrieved by "foreign" (that is, U.S.) multinational tech giants are waiting, impatiently, for the OECD proposal, which those countries believe will allow them to grab revenue from nonresidents and plug holes in their national budgets. International organizations, such as the G-20 and the EU, are likewise waiting on the OECD to unveil its consensus proposal.

We do not believe that the OECD effort is a failure. Just as Edison's tinkering was a necessary step toward the incandescent lightbulb, the OECD's pillar 1 is necessary to show the many choices, compromises, and assumptions that would be needed to impose a new and supplemental income tax system for a select few taxpayers. The sooner the OECD puts its proposal on the table, the sooner those choices, compromises, and assumptions will be subject to public scrutiny — and the sooner the debate can move to firmer ground.

We have previously expressed our concerns regarding the current version of the OECD proposal. To highlight a few points:

- Why digital companies? How to define those companies when virtually every business is now a digital business?
- Why consumer-facing companies? Business-to-business enterprises are equally dependent on reputation and customer feedback.
- How to define consumer-facing companies? The OECD has already boxed itself into something of a corner by saying it will exclude some industries.
- Why a revenue threshold, such as €750 million in annual revenue? If the new rules are sensible, should they not apply to everyone, or at least every multinational above a threshold much lower than €750 million?
- Using financial accounting data may be the only path forward, but what to do about obvious compliance and comparability issues?
- How to divide the revenue allocable to market countries among those countries?
- Who administers this system? Who conducts audits?

The list of concerns goes on, and most of the issues are now well known. But until the OECD puts forward its final proposal, we can all pretend that some genius — a tax equivalent of Edison — will find a solution.

Once the OECD releases its proposal, we believe the international tax world will fracture into three groups. One group of countries will immediately pass legislation to adopt the OECD approach; the legislation will simply impose tax in accordance with what the OECD has suggested. Those countries will then sit and wait and hope the tax revenue rolls in.

Another group of countries, probably led by the United States but not limited to the United States, will recoil. The thorny issues so evident to any tax professional will make administration of the new rules problematic. Those countries will urge patience by all countries until further discussion can refine and adjust the OECD proposal.

A third and final group will remain silent. Some of those countries have adopted interim measures and will seek to collect tax revenue that way. Other countries in that group will decide to adopt their own interim measures. A few countries will defer action until a path forward is clearer.

We find it perfectly sensible for market countries to seek to collect additional tax revenue from international business. The interim measures do this, albeit with no consensus on tax rates or technical details. Regrettably, there is no room for discussing technical details of the interim measures while the OECD's global income tax approach is pending.

If the OECD can finalize its proposal by the end of 2020, tax professionals can spend 2021 digesting its complexities and, we hope, moving toward a better approach. We think that better

© 2020 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

For more *Tax Notes® Federal* content, please visit www.taxnotes.com.

© 2020 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

approach will likely resemble the interim measures that the EU has endorsed and that many countries have already adopted.

Everything we have written here regarding international consequences of the OECD's proposal applies equally to state taxation of digital businesses (and other businesses) within the United States. There is no need to create a new, parallel income tax system and apply it to a few large companies. After *South Dakota v. Wayfair Inc.*, states can collect consumption taxes — sales taxes or use taxes — on sales to residents by most nonresident businesses. The nexus rules for imposing income tax on nonresident businesses can be complicated, but almost all large businesses with a national customer base already pay income tax in every state that imposes such a tax. States already have the tools to collect whatever level of tax they want from interstate business as well as intrastate business.

If the OECD proposal fails to achieve global consensus, as we expect, another quote from Edison may apply: "Our greatest weakness lies in giving up. The most certain way to succeed is always to try just one more time." We hope the next try discards the notion of a new global income tax and embraces an effort to harmonize gross-basis taxes such as those found among the interim measures.

A Sweeping Revision of Global Profit-Sharing Rules Is Needed

Steven D. Felgran

Ara Stepanyan

Steven D. Felgran is the founder of Felgran Economic Consulting LLC in New York and a former KPMG partner. Ara Stepanyan is an economist with Keystone Strategy in Boston.

"Only a crisis . . . produces real change. When that crisis occurs, the actions that are taken depend on the ideas that are lying around."

— Milton Friedman

We support the OECD's plan to update the global profit-sharing rules to allocate a portion of multinational enterprise group profit and related taxing rights to the so-called market countries. However, in our opinion it would be unwise to attempt to release recommendations in the face of this year's pandemic-induced recession. Further, we believe that a much more fundamental revision of the global tax and transfer pricing system is required that transcends the digital economy.

Should the OECD release its recommendations for taxing the digital economy this year, it is highly unlikely that governments would be prepared to act on them. It seems considerably more likely that the standout success of some tech companies in the current crisis might encourage more governments to initiate digital services taxes to help fill their massive fiscal holes. Such unilateral government actions might temporarily harm the OECD's efforts at tax reform and require additional negotiations to reverse down the road.

Nevertheless, our message to the OECD is to slow down, to not ring-fence the digital economy, but to take advantage of the lessons being learned from the crisis and reevaluate how best to fully achieve the goals of the base erosion and profit-shifting project. As the remaining challenges must be solved in the context of a fast-tracked digital transformation of the entire economy, it is counterproductive to make this a self-limiting exercise. Moreover, the OECD's current approach suffers by neglecting to rectify fundamental problems with the way transfer pricing analysis is done (outlined below) and layering onto the existing set of transfer pricing methods new formulaic profit allocation rules. Those rules would result in additional complexity for taxpayers and tax administrations alike and a possible onslaught of compliance issues and tax disputes.

The current pandemic-induced recession provides a wealth of information that can help guide the OECD toward a more complete and holistic set of policy recommendations for tax

For more *Tax Notes® Federal* content, please visit www.taxnotes.com.

reform and tax certainty that transcend the digital economy. Let's take a quick look at some of the problems first. If we examine the responses to the crisis by MNEs to date, we see not just broken supply chains, missing consumers, and massive debt and losses, but confusion and concern about many issues, including:

- whether transfer prices and profit outcomes can be changed without supporting real-time arm's-length evidence;
- whether losses are allowed at entities performing routine (benchmarkable) functions, especially limited-risk entities;
- whether new head office services costs pertaining to the crisis can be charged out;
- whether the value placed on intellectual property before the crisis resembles the current value;
- whether intercompany contracts remain valid in the face of the crisis, with or without *force majeure* clauses; and
- what kind of "story" needs to be told — and evidence shown — to the tax authorities down the road to explain below-the-range results and avoid audits and adjustments.

The crisis has made glaringly clear that the practice of transfer pricing, which rests on implicit assumptions about going concerns, reliable functional and risk profiles, and steady-state results, can collapse when unforeseen risks materialize and when real-time information on arm's-length behavior and outcomes is unavailable. Even without a crisis, the functional and risk profiles of the tested entities can be incomplete and misleading; the characterizations of entities as routine or non-routine can be arbitrary and superficial; the third-party comparables are often an outcome of subjective screening criteria; the data adjustments made to improve reliability can be stretched beyond credibility; and most unfortunately, companies can still engage in aggressive tax planning, which engenders costly enforcement and litigation efforts by tax authorities.

At a more macro level, the movement toward digitalization, robotics, and automation will accelerate because of continuing health concerns from the pandemic and continuing reductions in costs. That movement will be aided by relatively high savings rates (as the flip side of reduced consumption) that will propel investment spending.

The OECD should take all that into account in formulating recommendations for MNE taxation, which would subsume pillar 1's profit reallocation to market countries. We believe that the following concepts and principles should be front and center in new recommendations for measuring value among group entities and that tax should follow value:

- value creation must be measured from both the demand (consumption) and supply (production) sides;
- profit must be in alignment with the people-functions-centric measures of economic substance and value creation;
- transfer pricing analysis must be based on arm's-length criteria;
- the analysis must rely on the MNE's own objective, measurable, and verifiable data from its receipts or payments in competitive markets;
- MNE data that objectively measures value must include total employee compensation and revenue, both by country location;
- the outcome must be transparent and produce tax certainty; and
- tax loophole mining must be rendered unproductive.

When analyzing an MNE's profit allocation, we advocate identifying a direct link between value creation by people by country and the commensurate booking of taxable income by country. We view value as being created in the two kinds of countries in which an MNE has a physical or digital presence: the market-demand countries into which the MNE sells, and the production-supply countries in which the MNE has operations. We submit that in market-demand countries, the users or customers generate value for the MNE, and that in production-supply countries, the MNE's own employees generate value.

We advocate further that setting and documenting transfer prices make use of real-time data and information systems rather than imprecise comparables and out-of-date data. As opposed to standard practice, the OECD should consider a system in which transfer prices are based on data generated through actual company

For more *Tax Notes*® *Federal* content, please visit www.taxnotes.com.

© 2020 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

© 2020 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

practices, at points where the company touches the marketplace in uncontrolled transactions. Although historically those data have been inexplicably ignored by tax practitioners, recent popularization of data analytics tools puts those new approaches within easy reach of both taxpayers and tax authorities.

In conclusion, we believe the OECD should not release digital economy recommendations this year but rather process the insights gleaned from the effects of the pandemic-induced recession on international tax and transfer pricing. We are confident that the OECD can produce a more substantial set of tax reforms for the economy as a whole based on value creation and that any DSTs will be reversed once international agreement has been reached.

We're All in This Together — Separately

Helen Hecht

Helen Hecht is uniformity counsel for the Multistate Tax Commission, the organization created by U.S. states to work on uniformity issues in the area of corporate income tax and formulary apportionment.

For this roundtable, we were asked to discuss the OECD's work on taxing the digital economy, otherwise known as the Two-Pillar Approach to Address the Tax Challenges Arising From the Digitalisation of the Economy, or TPAATCADE (not sure the acronym will catch on). We were asked whether, given the pandemic, the OECD can finish its work this year as planned, and if not, whether its members should adopt digital taxes unilaterally. The answers are no, and maybe.

The last time I wrote on the subject of the OECD's efforts, I opined — "It's the Apportionment Formula, Stupid" — observing that taxing digital profits would inevitably require the application of formulary apportionment and urging the organization to put aside its resistance to that idea and focus on the questions to be answered.[1] Here, I will speak to the OECD's progress on another key issue — developing a new nexus standard — and what that may portend. But note that I have already predicted the OECD will not finish its work in 2020.[2] And that was before the pandemic.

Professor Richard Pomp writes extensively on what the OECD could learn from the states. And the Multistate Tax Commission stands ready to assist — although, from what I have seen, I suspect the OECD is blissfully unaware of our existence. I wish I could say the reverse was true. Every U.S. state (yes, even those that retain separate-entity filing) long ago gave up pretending that it is possible to determine the amount of profit a multistate company earns in a particular geographic location by separately imputing various items of cross-border income and expense, estimating the value of those items using arm's-length pricing, and then sourcing the items based on a complex set of specific rules — that is, the international system. Nevertheless, in the 1980s international pressure forced the states to rely on this very system to determine the domestic tax base. States therefore have had no choice but to pay attention to the OECD's BEPS project. But here we are, over a decade after that project began, and the OECD is just beginning to face the deficiencies of this international system as it applies to ever-more-virtual commerce.

Before I go further, let me say that I'm familiar with the difficulty of drafting uniform tax policies in multilateral committees. They are legion. And I have no wish to throw stones. Still, I struggle for a charitable description of the OECD's progress. (It's too bad "lumbersome" is not a word.) I don't chalk up the lack of progress to the difficulties of multilateral action alone — but to the sunk cost fallacy. The OECD persists in throwing good money after bad, as it were, in propping up the international system rather than reforming it.

I could cite many examples, but take the nexus issue. As late as last year, the OECD described its work as "the design of a new nexus rule that

---

[1] *See* Helen Hecht, "Board Briefs: States Taxing a Digitalized Economy," *Tax Notes State*, Apr. 6, 2020, p. 39.

[2] Hecht, "Board Briefs: Farewell 2019, Hello 2020!" *Tax Notes State*, Dec. 16, 2019, p. 884.

For more *Tax Notes® Federal* content, please visit www.taxnotes.com.

© 2020 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

would capture a novel concept of business presence in a market jurisdiction reflecting the transformation of the economy, and not constrained by physical presence requirement." Assuming the OECD is speaking of economic presence, its use of the term "novel concept" is telling. Forget that the states have asserted economic nexus for income tax purposes for over 20 years. Economic presence has underpinned the theory of general jurisdiction for decades. It would probably be more accurate to say the OECD has known about, and disfavored, this concept for some time, because it conflicts with the permanent establishment rule.

But of greater concern is the description of the standard proposed as "reflecting the transformation of the economy," which is a troubling level of abstraction for a critical element of a plan due out in mere months. How I wish the OECD had described its vision of the new nexus rule this way: In an apportionment-based system, there is an essential connection between the nexus standard and apportionment factors if "nowhere income" is to be avoided; and using apportionment factors as the nexus threshold also leverages the administrative costs of generating that apportionment information.[3]

Still, it's been a year since this very aspirational statement. Let's consider the OECD's recent description of the work remaining (comprising 11, count 'em, 11 "work streams"). Included in that work are:

- Deciding which businesses are subject to the new nexus rule.
- Developing the proper "revenue and profit thresholds."
- Considering the need to reflect "sustained engagement with market jurisdictions, which could in some circumstances be unconstrained by physical presence."
- Deciding which data to use to calculate thresholds; making thresholds compatible with apportionment factors.
- Identifying proper industry-specific standards; developing sourcing rules — including the treatment of sales made through intermediaries.
- Avoiding double counting.
- Creating a dispute resolution process.
- Making necessary revisions to tax treaties.

That's a lot of work, as the states well know. And if I thought the OECD was open to learning from the states (both what to do and what *not* to do), I might be a little less skeptical that they can go from abstract concept to fully fleshed-out proposal in less than a year's time. But the bottom line is that you move much slower when you're dragging your feet. In any case, I'm not the only skeptic. The staff of the project have repeatedly expressed doubts that the work can be finished — and when I say finished, I mean ready for release to the public (at which point, all you-know-what will probably break lose).

Still, the question remains — should the OECD members simply begin to enact their own taxes on digital profits? You may think the need for public revenue will force governments to take matters into their own hands. But I have been struck by how many political leaders have lately admitted, no matter how exceptional their own country or state might be, there are some problems best solved by cooperation. (Yes, Gov. Cuomo (D, NY), I'm looking at you.) What does this counsel for the OECD members? Whatever you do, continue to support the OECD, leverage what the OECD has already done, and continue to build relationships necessary for tax enforcement. In other words, our individual interests are best served by pushing forward together (even if you have to do it separately).

What Can the OECD Learn From the States?

Richard D. Pomp

Richard D. Pomp is the Alva P. Loiselle Professor of Law at the University of Connecticut School of Law.

A few months before the widespread devastation unleashed by the coronavirus pandemic, nearly 140 countries agreed to formulate a plan for modernizing the income taxation of multinational corporations. The director of the

[3] *See* MTC, "Factor Presence Nexus Standard for Business Activity Taxes" (updated Sept. 2003), based on the work of Charles McLure.

For more *Tax Notes*® *Federal* content, please visit www.taxnotes.com.

© 2020 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

OECD's Centre for Tax Policy and Administration acknowledged that the date "may look a bit insane," but the alternative is the risk of trade wars based on tax disputes. Today — in the middle of a global economic depression — that risk looks downright tame. The real risk is that the implosion of economies throughout the world will lead countries to recede to the basest and darkest of human emotions.

Insane or not, the end of 2020 is no longer aspirational but has now become a critical deadline. The pandemic has made taxing jurisdictions around the world desperate for money if their institutions are to survive. The OECD needs to recognize that the states developed a better mousetrap in dealing with cross-jurisdictional corporations. It is time their experiences should be recognized as a model to be emulated.

A. Historical Perspective[4]

Necessity is the mother of invention, and at the beginning of the 20th century the states were forced to develop a better alternative to federal transfer pricing and sourcing rules. Long before the dramatic rise of the multinationals after World War II, which started to expose the weaknesses in the federal rules and in the bilateral income tax treaties, the states had to respond to the challenge of taxing interstate corporations.

To deal with this, after a few inadequate starts, formulary apportionment emerged as the consensus approach in the early 20th century, building on the taxation of interstate railroads. Some states, under the intellectual leadership of California, started combining domestic related entities by the mid 1930s, which eliminated the need to police transfer prices and the shifting of profits to domestic tax havens (such as Nevada in the case of California). The apportionment formula would determine how much of the tax base a state could tax, substituting for the primitive federal sourcing rules.

The IRS was essentially indifferent to purely domestic interstate corporations, which typically filed consolidated returns. Consequently, interstate corporations posed no tax problem at the federal level, unlike the challenges they presented at the state level.

To be sure, there were a small number of U.S. corporations with foreign activities as early as the mid-19th century, such as the Singer Manufacturing Co. — incorporated in 1851 and often cited as the first U.S.-based multinational — selling sewing machines first in Europe and later in India, Australia, South Africa, and New Zealand. By the end of the 19th century, Singer was joined by other multinationals of the time, including Westinghouse, General Electric, Eastman Kodak, and Standard Oil.

B. The Rise and Fall of Mandatory Worldwide Combined Reporting

These multinationals presented special problems for both the IRS and the states, especially after World War II. The IRS used the federal transfer pricing and source rules, in the context of international tax treaties, and many states often piggybacked on this, accepting the resulting federal allocation of income as their starting point.[5] But some states that were combining domestic corporations went further, and extended this technique to include foreign entities, a method known as worldwide combined reporting.

The major advantages are obvious. Tax havens are combined, bringing their income back into the tax base. The need for the global intangible low-taxed income (GILTI) regime and similar approaches is eliminated. Tax minimization games built around income shifting are undercut, if not fully stopped. The manipulation of tax treaties is eliminated.

Although a tax treaty with the United Kingdom unsuccessfully tried to halt mandatory worldwide combined reporting, political pressure from the Reagan administration bullied California and those in its fold to stop using this approach. The lesson for the OECD (and the EU) is that this retrenchment was political in nature and not because of administrative obstacles (although critics would allege otherwise).

---

[4] *See* Richard D. Pomp, *State and Local Taxation*, 9th ed. 2019, pp. 10-1 through 10-8; 10-40 through 10-79.

[5] One early exception was New York. *See Bass, Ratcliff & Gretton Limited v. State Tax Commission*, 266 U.S. 271 (1924).

For more *Tax Notes® Federal* content, please visit www.taxnotes.com.

© 2020 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

C. Production vs. Market[6]

Much of the European debate is over how to assign the tax base between the production country and the market country. The states have fought this battle at least since 1957 when the Uniform Law Commission brought us the Uniform Division of Income for Tax Purposes Act (UDITPA). UDITPA sets forth an evenly weighted three-factor formula, using property, payroll, and sales. In the case of tangible personal property, sales are attributed to the state in which the goods are delivered or shipped. That formula thus incorporates two production or origin factors (property and payroll) and one market factor (sales).

For all other sales, most notably services, UDITPA assigns the receipts using what is known as the costs of performance approach. In this case, there is an all-or-nothing approach: The one state in which the greatest costs of income-producing activities occurs receives all the receipts. (Some states reject this all-or-nothing approach and utilize a proportional methodology.)

Of special interest to the OECD (and the EU) is the dissatisfaction with the production bias inherent in the costs of performance approach. Instead, states have been replacing that approach by using a market-based approach to the sales factor (and some go even further, apportioning income using only sales). The MTC, probably the greatest depository of intellectual firepower in the field, has spent two years drafting exhaustive rules designing different approaches to market-based sourcing depending on the type of transaction involved.

The OECD should design its own formula, factors, and their respective weighting, but the MTC has done the heavy intellectual lifting. And the MTC has special formulas for special industries.

D. Nexus

With the fairly recent U.S. Supreme Court case *South Dakota v. Wayfair Inc.*,[7] the physical presence rule imposed under the commerce clause was rejected in sales tax cases, similar to the movement to eliminate the PE rule that is at the heart of existing bilateral income tax treaties. The experience of the states post-*Wayfair* is another source that can be drawn upon. Moreover, long before *Wayfair*, the states were imposing economic nexus rules in their income taxes. The MTC developed "factor presence" rules for nexus, which incorporated economic nexus approaches. Free of any commerce clause constraint, the OECD can also draw on this experience in designing its nexus rules.

E. Adopting Mandatory Worldwide Combined Reporting

Without a commerce clause to deal with, the OECD has more latitude than the American states to adopt a worldwide combined approach. (All the U.S. litigation over the definition of a unitary business, a precondition under the commerce clause to combination, would be irrelevant.) Once again, the MTC and the states have relevant experience to draw on. Mandatory worldwide combined reporting, with a well-designed apportionment formula, is a better alternative to the OECD's agenda. It deals better with tax havens, transfer pricing, defining specific types of businesses, such as digital or "consumer-facing," profit shifting, and the allocation of overhead. It nicely addresses the digital economy and undercuts many tax minimization strategies.

F. The Combined Tax Base

One area in which the state experience will not be useful, however, is the nature of the tax base to be combined. Neither UDITPA nor the MTC addresses this critical issue. International accounting standards and the Common Consolidated Corporate Tax Base could fill the void as a starting point. I have enough friends who are financial accountants and who, like tax lawyers, can make anything so complicated that the temptation is to throw up our collective hands in frustration. Experienced draftspersons know, however, that "the perfect is the enemy of the good." Persons working in good faith and with an urgent sense of mission can arrive at something good enough to be workable.

Helen Hecht's contribution in this installment summarizes the OECD's ambitious 11 "work

[6] *See* Richard D. Pomp, Report of the Hearing Officer, Multistate Tax Compact Article IV, [UDITPA], Proposed Amendments (2013).

[7] 138 S. Ct. 2080 (2018).

For more *Tax Notes*® *Federal* content, please visit www.taxnotes.com.

streams." The states have much to offer in resolving the issues addressed by these work streams. It is unnecessary for the OECD (or the EU) to reinvent the wheel when the states already own the original patent.

G. Administering a Worldwide Combined Reporting

Many countries will be unable to administer a worldwide combined reporting regime without help. My preference would be for a nongovernmental organization that has the capability, expertise, and sophisticated personnel who can climb the needed learning curve, to take on this burden on behalf of *all* countries. The OECD, the U.N., the IMF, or the World Bank would be logical candidates. Resistance can be expected, of course, to this new global tax and the resulting international bureaucracy, with conspiracy fanatics being unleashed and warning of "black helicopters" and "world domination." But the real fear is not this lunacy, but rather the dystopian world we will be moving toward if there is not sufficient revenue to rebuild economies and bolster democratic institutions by the end of 2020.

State of the OECD Digital Project

Rick Minor

Rick Minor is a U.S. lawyer and tax policy expert and a member of the OECD technical advisory group on consumption taxes.

As government finance ministries design and administer COVID-19 relief programs, dedicated personnel are returning to the OECD digital project with the same intensity as before the global economic crisis began. The inclusive framework members are adjusting to the benefits and burdens of virtual meeting technology in lieu of in-person meetings and the usual intimate arm-twisting and coaxing that takes place during those breaks.

As of late May, there was increasing optimism from the OECD that consensus would be reached on some if not all of its project recommendations by or before the original year-end 2020 deadline. Pascal Saint-Amans, director of the OECD Centre for Tax Policy and Administration, expressed optimism in a May 21 virtual conference that consensus on the pillar 2 minimum tax proposal would emerge by October. OECD Secretary-General Angel Gurría similarly predicted that the OECD would meet the original 2020 deadline and present its recommendations for approval at the November G-20 meeting. Although Gurria's statement was probably intended to motivate the inclusive framework countries to speed up their buy-in of the recommendations, it also increased the pressure internally on the OECD to deliver on its deadline. That achievement, in turn, requires overcoming multiple hurdles to consensus at the country level. Right now the assumption is that the 2020 deadline will be met.

There was already pressure on the OECD in March, in particular from the U.S. business community, to postpone its timeline to 2021 because of technical and COVID-19 concerns. The original July date for the next inclusive framework plenary session was pushed back to October, which also reduces any distraction that might arise with the U.S. presidential election in early November.

It will ultimately be the OECD's decision on whether further delays are warranted based on the complexity of country-specific hurdles to consensus. It will evaluate how many inclusive framework countries it takes to make a consensus and to what extent, if at all, a consensus can be considered achieved without the support of the United States or China on all recommendations. Can consensus be considered reached with 80 percent or more approval from the G-20? Or must agreement at that level be unanimous? We will see.

Will Governments Be Prepared to Act?

At the national (foreign) and U.S. federal government level, I would expect any consensus agreement from the OECD project to include effective dates for implementing legislation. If a member of the inclusive framework is part of the consensus, that member will have signed up for the legislative implementation timeline tied to specific proposals. One timing scenario is that countries must enact the OECD recommendations

For more *Tax Notes*® *Federal* content, please visit www.taxnotes.com.

© 2020 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

into legislation for a January 1 effective date, allowing at least a full calendar year between the time of any OECD agreement and January 1 of the year in which the implementing legislation takes effect. For example, a proposal agreed in 2020 would be effective for 2022, one agreed in 2021 would be effective for 2023, and so forth. Timing will also be affected by the kind of detailed guidance the OECD will be expected to generate once consensus is reached to insure consistent implementation at country level. The preparation of such detailed guidance, including likely public consultations on draft guidance, could add significant time to the legislative process.

The issue at the U.S. state level will be the same as with implementing the international (and other taxpayer-friendly) provisions under the 2017 Tax Cuts and Jobs Act (P.L. 115-97) — namely, to what extent states will conform their corporate tax base rules to special provisions from the OECD project that affect the U.S. federal tax calculations (including notionally decreased tax rate benefits) for corporate taxpayers. The experience with the TCJA has been mixed — some states have conformed provisions and others have not. If it is possible to generalize, some states have not conformed TCJA legislation to the state tax code when the TCJA legislation reduces the tax base of the corporate taxpayer. States have learned from their TCJA experience and will be keen to make timely decisions on the conformity of any OECD consensus legislation on which the U.S. agrees. When there is conformity at the state level to the U.S. federal calculation, the state rules should take effect at the same time as the U.S. federal rules.

Any OECD consensus reached is likely to include the support of all 27 EU member states. Whenever member state unanimity on fiscal legislation is achieved, the European Commission drafts the implementing legislation, which all member states are required to use. Drafting uniform taxing legislation in the form of a directive or a regulation is a core function of the commission and it does a great job now in generating work product as the commission has become much more active in the BEPS age. There is a well-functioning system in place now consisting of the experts in TAXUD, the commission tax department, and the member state finance ministries that make this drafting process very efficient.

Consensus or No Consensus?

The OECD recommendations exist but may still evolve in pursuit of consensus. What happens if consensus is not reached on the recommendations on the table, or consensus is reached but key countries such as the United States and China don't accept one or more of the agreed recommendations? In the former case, countries will then be free to act unilaterally and adopt OECD-inspired legislation at the national level, as the United States did with international provisions in the TCJA, such as the base erosion and antiabuse tax and GILTI.

The EU is the OECD stakeholder best positioned to proceed with OECD-inspired legislation absent a final inclusive framework agreement. This advantage stems from the quasi-legislative authority the European Commission enjoys and the virtually unanimous support of the member states and the European Parliament for EU action with or without OECD consensus. Germany, one of the most vocal supporters of the OECD digital project, assumes the rotating six-month European country presidency July 1. Consequently, its presidency overlaps with some of the most important milestones in the OECD digital project, as mentioned above. Germany could leverage its presidency to establish leadership in the OECD deliberations in the second half of this year, not only for itself but also in the pursuit of unanimous support in the EU for the consensus position.

The 2019 pledge by European Commission President Ursula von der Leyen for the EU to go it alone in the absence of OECD consensus at the end of 2020 virtually ensures that the European Commission would move quickly on legislation. The commission includes as an option the common consolidated corporate tax base initiative for its digital tax response. Less certain is whether the EU in this go-it-alone scenario will revive the DST it introduced in draft form in 2018 and that inspired the current French DST legislation. In paragraph 9 of its May 15 resolution, the EP called for a DST to become a new source of "own resources" revenue for the European Commission (a common consolidated

© 2020 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

For more *Tax Notes® Federal* content, please visit www.taxnotes.com.

corporate tax base is also included in the list of new sources). But it is not entirely clear what the reference in the resolution to the DST means. Based on the EU's "own resources" concept, which already levies uniform EU revenue taxes such as VAT, it is difficult to see how the reference cannot be to an EU-wide DST. The point is whether in the absence of OECD consensus the EP will increase pressure on the non-democratic EU Council of Finance Ministers to adopt a DST, thus challenging the current assumption that an EU DST is off the table. In its December 18, 2019, resolution on the OECD project, the EP neither supported nor criticized the DST as a go-it-alone option for the European Commission. The current COVID-19 economic crisis could be the game changer for the EP to take a position in favor of the DST. Before the economic crisis, this was unlikely to happen.

Given the OECD's constant warnings that DSTs will automatically lead to trade wars with the United States, it may have genuine concerns that more governments than on the current list will enact DSTs. The commission already suggested in 2019 that it will retaliate as an economic unit against any U.S. trade measures taken against individual member states on account of their DSTs. As France, Austria, and other countries have demonstrated, it is fairly routine to enact national DSTs and put into place a compliance system for collecting the DST. The DSTs that are on the books to date have been designed to generate a relatively small amount of revenue from a small class of very large taxpayers. As a new tax, any flaws in the administration of the tax will be corrected with experience. Naturally, there are technical objections from those taxpayers and very aggressive reactions from the U.S. Congress and the U.S. administration. The conflict may focus now on a few simple sound bites, but the DST dilemma has become even more complex in a COVID-19 economic crisis that will affect national budgets globally for the foreseeable future. The DST has introduced the notion that "unilateral" taxes, however defined, are not legitimate in the new world of global fiscal coordination. Could an EU-wide DST of any kind be considered unilateral in this sense when agreed unanimously by 27 member states?

Do We Need New (Digital Services) Taxes to Finance the Recovery?

Aleksandra Bal

Aleksandra Bal is an indirect tax specialist based in Amsterdam. This article was written in her personal capacity. It represents her views and should not be attributed to any organization with which the author is affiliated.

Cash-strapped governments around the world will need robust revenue sources to finance their massive stimulus programs and the recovery from the COVID-19 crisis. However, as the pandemic has severely crippled business and trade, the traditional revenue sources may not be enough to support the recovery efforts.

Although post-crisis fiscal policies will vary across the globe, there are three potential strategies to secure more tax revenue: (1) strengthening the efforts to combat aggressive tax planning and tax avoidance by closing loopholes in the tax systems; (2) expanding the scope of existing taxes; and (3) introducing new taxes (for example, a DST).

Regarding the first potential response, the European Commission has recently reminded the EU member states that the COVID-19 crisis has made the fight against aggressive tax planning an "even clearer priority than in the past." It has proposed several recommendations to curb tax avoidance schemes to six countries — Cyprus, Hungary, Ireland, Luxembourg, Malta, and the Netherlands — that still have tax regimes that facilitate aggressive tax planning.

Many countries will opt to get more revenue from the existing tax sources to mitigate the economic impact of the COVID-19 pandemic. India did so already in April by expanding the scope of its equalization levy. The equalization levy was originally introduced in 2016 in the form of a 6 percent tax on gross revenues from online advertising services as a measure to address the tax challenges posed by the digitalization of the economy. Now a 2 percent levy applies to revenue from all electronic commerce provided in India by

For more *Tax Notes® Federal* content, please visit www.taxnotes.com.

© 2020 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

nonresident businesses. Indonesia is planning to impose a 10 percent VAT on digital services provided by nonresident companies to Indonesian consumers from July 1. In July, Saudi Arabia will triple its VAT rate (from 5 percent to 15 percent) to support its coronavirus-hit economy. More countries may follow suit. VAT seems to be more resistant to crisis than direct taxes, and that is why many EU member states increased their VAT rates following the financial crisis of 2008.

There are also countries that may see the pandemic as a reason to introduce new taxes and search for new revenue streams. These new taxes may take various forms. For example, Poland is planning to introduce a 1.5 percent special tax on revenues of the main streaming providers (Netflix, Ipla, Amazon, and Apple TV+) as part of the new COVID-19 relief measures. If implemented, the tax is expected to generate around PLN 15 million (€3.3 million) in revenue this year.

The European Commission has recently announced its intention to introduce a new European tax: a "market access fee" that will affect 70,000 companies with global turnover exceeding €750 million has been mentioned in the "Recovery Plan for Europe" as part of measures to finance the EU recovery from the COVID-19 crisis. The new levy will take the form of an annual lump sum payment and will vary depending on the company's size. The EU budget commissioner said that is no practical alternative but to create new sources of direct revenue for the EU budget and called on the member states to support the new levy. It's the first time that the EU wants to introduce its own direct tax.

DSTs have often been named as options for raising revenue to finance the recovery from the current pandemic. As the OECD has shifted the timing of an agreement on how to tackle the tax challenges arising from digitalization to October (and some parts of the solution may even be postponed to 2021) and the need for additional revenue is now greater than ever, there is an increasing risk that DSTs could start proliferating around the world, at least as a temporary solution. French Finance Minister Bruno Le Maire recently said the "proposal to tax the digital giants is more current than ever" and countries should accelerate their efforts to tax digital multinationals.

On the one hand, the interest in DSTs seems understandable given that some digital companies seem to be immune to the impact of the coronavirus crisis and even profit from it as the economy has moved from physical to digital. On the other hand, digital services and goods belong to the key infrastructure that allows the economic activity to continue during the lockdown. They are now in high demand as people work remotely, shop and study online, and meet their business partners virtually. It seems counterproductive to impose a heavier tax burden on the elements of the infrastructure that have played a crucial role during the COVID-19 pandemic.

Another argument against imposing DSTs is that these unilateral measures are likely to trigger a response in the form of new tariffs from some countries. Needless to say, a trade war would be extremely harmful to the global economy in the current situation and should be avoided at all costs. So should a potential negative impact of DSTs on consumers and smaller businesses. One multinational that would be affected by the French DST openly said the extra tax costs will be passed on to consumers and business partners using its online platform. The introduction of additional revenue taxes on the use of digital business models could also discourage traditional companies from starting digital transformation processes, thereby reducing their competitiveness, as companies will be wary of both the additional tax burden and increased compliance costs.

Finally, the contribution of a DST to the total tax revenues of a country needs to be evaluated. The French DST is estimated to generate between €400 million and €650 million per year. This amounts to approximately 0.05 percent of total French tax revenues. The Austrian Ministry of Finance hopes to collect between €25 million and €34 million in DST revenue. This also represents an insignificant part of Austria's tax revenues (0.02 percent). These numbers clearly show that the contribution from DSTs to the overall tax revenues appears to be insignificant and not likely to speed up recovery efforts.

© 2020 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

For more *Tax Notes® Federal* content, please visit www.taxnotes.com.

In conclusion, any new form of taxation should be well thought out and supported by sound economic impact analysis. Because many countries' focus will soon shift to fiscal policies designed to foster economic growth and investment, they might not have enough resources to carefully evaluate the impact of both DSTs and the OECD proposals on their economies. Therefore, it makes sense to postpone digital tax projects until the path to recovery from the crisis becomes clearer. ■

taxnotes®

Education | Debate | Fairness | Transparency

We're on a mission.

Creating a marketplace of ideas and an atmosphere that fosters public debate, where exchanges are open, all sides of the aisle are represented, and all ideas are welcome.

We publish world-class news and analysis, host and provide speakers for conferences on topics that matter, provide material for free on taxnotes.org, and pursue the release of important public information through the Freedom of Information Act.

Find out more at taxnotes.com.

© 2020 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

For more *Tax Notes® Federal* content, please visit www.taxnotes.com.